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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 916

FRANK L. WEIL, WILLIAM E. RUSSELL AND RAYMOND J. SCULLY, AS TRUSTEES UNDER A DECLARATION OF TRUST DATED APRIL 7TH, 1936 AND A PLAN OF REORGANIZATION OF SERIES C-2 MORTGAGE INVESTMENTS APPROVED BY AN ORDER OF THE SUPREME COURT OF THE STATE OF NEW YORK ENTERED ON THE 16TH DAY OF JANUARY, 1936,

Petitioners,

vs.

THE UNITED STATES OF AMERICA.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable The Chief Justice and Associate Justices of the Supreme Court of the United States:

Summary Statement of Matter Involved.

This case challenges the right of the United States Government to exact a documentary stamp tax on the transfer of certain corporate bonds under and pursuant to the pro-

visions of Schedule A-9, Title VIII of the Revenue Act of 1926, as amended by Section 724A of the Revenue Act of 1932 (R. 6, 7, 14) (Appendix, p. 29).

The taxing statute and the pertinent Treasury Regulations, insofar as these transfers are concerned, are set forth in the appendix hereto at pp. 29-32.

The transfers upon which the tax was exacted were the assignments of corporate bonds, securing the payment of various indebtednesses further secured by first mortgages on real estate (R. 5, 6, 9, 10). The transfers were from Louis H. Pink, Superintendent of Insurance of the State of New York, as Liquidator of the New York Title and Mortgage Company (hereinafter referred to as the "Superintendent") and Mortgage Commission of the State of New York (hereinafter referred to as "Mortgage Commission") to Frank L. Weil, William E. Russell and Raymond J. Scully as Trustees of Series C-2 mortgage investments issued and guaranteed by New York Title and Mortgage Company, petitioners herein (R. 6).

The New York Title and Mortgage Company (hereinafter referred to as "Guarantee Company") was one of many companies engaged in the business of making loans secured by bonds and first mortgages. Undivided interests in these bonds and mortgages, called certificates, were then sold to investors with an accompanying guaranty of principal and interest by the Guarantee Company. Where undivided interests in a single bond and mortgage were sold, it was identified as an individual issue, and where undivided interests in pools of bonds and mortgages were sold, they were identified as group issues. Among these group issues was one with over 100 bonds, mortgages and properties, representing $24,184,788.54 in principal amount, sold to approximately 7500 investors, which constituted the Series C-2 issue of the Guarantee Company (R. 3).

In 1933, there was a complete and general collapse of all of these companies, caused by a variety of economic factors, which resulted in part from the unprecedented decline in real estate values and the oppressive obligations represented by the guaranties which the companies were required to meet (R. 3).

In order to avert a major economic disaster, these companies were taken over for rehabilitation by the Superintendent pursuant to Article XI of the New York State Insurance Law. The powers conferred by this section, however, were inadequate to enable the Superintendent to administer and reorganize the properties and mortgages involved for the benefit of the investors. In order to supplement the powers granted to the Superintendent by Article XI of the Insurance Law, the "Schackno Act" (Chapter 745, New York Laws 1933, as amended, Unconsolidated Laws of New York, Sections 1796-1807 inclusive) was enacted (R. 4 and appendix pp. 32-38).

The "Schackno Act" also embodied the legal and procedural mechanism for plans of reorganization resulting in the appointment of permanent trustees as successors to the Superintendent and later the Mortgage Commission (Appendix pp. 32-38).

Pursuant to the provisions of Article XI, as supplemented by the "Schackno Act", the Superintendent acquired legal title to all bonds and mortgages representing the issues of the Guarantee Company, including the Series C-2 issue (R. 4).

It is conceded by the government that the transfers from the Guarantee Company to the Superintendent, pursuant to Article XI of the Insurance Law of the State of New York and the Schackno Act, were wholly by operation of law and, therefore, not taxable.

Despite the implementation of the Insurance Law by the Schackno Act, the office of the Superintendent was found

to be equipped neither to administer temporarily nor to reorganize the vast number of issues involved. This reason, among others, caused the New York State Legislature to create a separate State agency to assume the burden of administering temporarily and reorganizing these issues in the place of the Superintendent. (Section 1 of the Declaration of Cause, Chapter 19 of the Laws of 1935, as amended, appendix, pp. 38-41.)

Hence, by the Mortgage Commission Act (N. Y. Laws 1935, Chapter 19, as amended) the Mortgage Commission was created as a provisional organization and its existence was limited to January 1, 1940 (Appendix, p. 57). The sole function of the Mortgage Commission was the temporary administration and reorganization of the guaranteed mortgage properties pending judicially approved reorganizations effecting a final turnover to permanent trustees.

The Mortgage Commission Act incorporated by reference those provisions of the Schackno Act which created the statutory machinery for the promulgation of plans of reorganization (Appendix, pp. 45, 54, 55). In addition thereto, the Mortgage Commission Act provided for an alternative legal and procedural mechanism for the promulgation of these plans (Appendix, p. 48). Either procedure required reorganization upon court order. According to the Schackno Act procedure, prior to the making of the court order, the holders of two-thirds in principal amount of the certificates outstanding in any particular issue were required to consent (Appendix, p. 36). According to the Mortgage Commission Act procedure, a court order could be made approving the plan, if the holders of one-third in principal amount of the certificates outstanding failed to dissent (Appendix, pp. 49-50).

Pursuant to the Mortgage Commission Act, the Mortgage Commission acquired title to the securities underlying the various issues, including those of Series C-2, and became

Trustee for the benefit of certificate holders (the *cestuis*), (R. 4). The Mortgage Commission Act, defining and limiting its powers, was the declaration of trust under which it acted (McKinney's Unconsolidated Laws of New York, Sections 1751-1785 incl.).

The transfers of securities from the Superintendent to the Mortgage Commission pursuant to the Mortgage Commission Act were conceded by the Government to be "wholly by operation of law", and not taxable.

The instant case employed the mechanism of the "Schackno Act" to effectuate the transfers from the Mortgage Commission to permanent trustees, the petitioners herein. To this end, the Mortgage Commission promulgated a plan which, after a hearing, was approved by the interlocutory order of Mr. Justice Alfred Frankenthaler of the New York Supreme Court, who had exclusive judicial supervision of the guaranteed mortgage situation in New York County. Thereupon, the Mortgage Commission obtained the consent of the holders of two-thirds in principal amount of the certificates outstanding. The plan was then approved by the Supreme Court of the State of New York by final order dated January 15, 1936. The Trustees, petitioners herein, were appointed by Mr. Justice Frankenthaler to act under a declaration of trust approved by him (R. 5). Immediately upon their qualification, title vested in the petitioners (R. 50, 51) by virtue of the specific provisions in the court order and the plan (R. 50, 51, 91) and in accordance with authority contained in the statute (Appendix, p. 48). They were to liquidate the issue for the benefit of the holders according to the terms of the Declaration of Trust and the plan of reorganization (R. 60).

Over protest, the government collected from the petitioners a tax of $6,361.64 on the transfers of the corporate bonds to them from the Mortgage Commission.

On May 11th, 1938, petitioners filed with the Commissioner of Internal Revenue a claim for refund which was disallowed on September 24, 1938 (R. 7).

Petitioners then instituted this suit in the District Court for the Southern District of New York to recover the tax paid (R. 2-10, inclusive). No issue of fact having been raised by the pleadings, both sides moved for summary judgment (R. 16-95, inclusive). These motions were argued before Hon. Henry W. Goddard, District Judge. Pursuant to the court's opinion, filed on November 8th, 1938 (R. 96-102, inclusive) an order was entered in that court granting petitioners' motion for summary judgment, striking out the Government's answer and denying the Government's motion. Judgment was thereupon entered on November 2nd, 1939, in favor of the petitioners for $6,361.64, with interest thereon and costs in the amount of $5.00 (R. 103-105, inclusive).

The Government appealed to the Circuit Court of Appeals for the Second Circuit (R. 106). By order entered January 2nd, 1941 (R. 118, 119), the judgment of the District Court was unanimously reversed pursuant to the opinion of Hon. Augustus N. Hand, Circuit Judge, filed on December 16, 1940 (R. 111-117, inclusive).

Opinions Below.

The opinion of the Circuit Court of Appeals for the Second Circuit (R. 111-117) is reported in 115 F. (2d) 999, and that of the District Court for the Southern District of New York (R. 96-102) is reported in 30 Fed. Supp. 349.

Basis of Decision of the Court Below.

The court below held the transfers herein taxable for the following reasons:

1. That this Court had construed the taxing statute literally and was altogether strict in subjecting the transfers

to a tax. *Raybestos-Manhattan, Inc.* v. *U. S.*, 296 U. S. 60; *Founders General Corp.* v. *Hoey*, 300 U. S. 268; *Koppers Coal and Transportation Co.* v. *U. S.*, 107 F. (2d) 706.

2. That the two-thirds consent of the certificate holders was a voluntary act and therefore the transfer was not wholly by operation of law.

3. That although New York law held similar transfers to be by operation of law (*Terminals Transportation Corp.* v. *State*, 169 Misc. 708, 8 N. Y. Supp. (2d) 282, affd. 14 N. Y. Supp. (2d) 493, 281 N. Y. 889; #23; *Electric Bond and Share Company* v. *State*, 249 App. Div. 371, Affirmed 274 N. Y. 625) it must be disregarded in construing the statute here in question, *Burnet* v. *Harmel*, 287 U. S. 103.

Basis of Jurisdiction.

This is a petition for a writ of certiorari to review the final judgment of the Circuit Court of Appeals for the Second Circuit, reversing the judgment of the District Court for the Southern District of New York in favor of the petitioners and granting final judgment in favor of the Government, respondent. Jurisdiction is invoked under Section 240 (a) of the Judicial Code, as amended (Section 347a of Title 28 U. S. C. A.) (Appendix, p. 29).

The Question Presented.

Were the transfers of the corporate bonds herein effected "wholly by operation of law" and consequently exempt from taxation under Schedule A-9, Title VIII of the Revenue Act of 1926 (as amended by Section 724a of the Revenue Act of 1932) and Treasury Regulations 71?

Reasons Relied On for the Allowance of the Writ.

1. The Circuit Court of Appeals for the Second Circuit has decided erroneously, petitioners submit, an important

question of Federal law which has not been, but should be, settled by this Court.

The transfers in suit are prototypes of thousands of other transfers arising under the same New York statutes. A decision in this case will determine the taxability of such other transfers.

Pursuant to the Mortgage Commission Act, there were transferred approximately 15,000 properties and mortgages totalling over $675,000,000 in principal amount. A substantial proportion of these transfers were of corporate bonds which were, in effect, held taxable by the decision of the court below. These transfers involved over 250,000 individual certificate holders residing throughout the United States and in foreign countries.

This unwarranted Federal tax was imposed on scores of thousands of certificate holders whose life savings were jeopardized and depleted by the collapse of the mortgage guarantee companies.

The State of New York fully appreciated the plight of the certificate holders and created legislation to alleviate their distress by successive transfers of the bonds and mortgages securing their investments from the insolvent guarantee companies to two state agencies: first the Superintendent and then the Mortgage Commission, and, finally, to court appointed Trustees. These steps were merely part of a State statutory scheme to attempt to salvage these investments. These constructive ~~effects~~ of the State of New York will be vitiated to the extent that transfer taxes were imposed which will be permanently siphoned directly from the certificate holders unless the order herein made by the Circuit Court of Appeals is reversed.

2. The decision of the Circuit Court of Appeals for the Second Circuit in this case is in direct conflict with the decision of the Ninth Circuit in *U. S.* v. *Merchants National*

Trust and Savings Bank, 101 Fed. (2d) 399, in three respects. The conflicts concern the question of the application and controlling effect of State Law regarding the nature of the transfers herein and the interpretation and application thereto of Articles 35 (h) and 35 (r) of Treasury Regulations 71.

3. The Circuit Court of Appeals for the Second Circuit has decided a Federal question in conflict with applicable decisions of this Court concerning the controlling effect of State Law. *Morgan* v. *Commissioner,* 309 U. S. 78; *Lang* v. *Commissioner,* 304 U. S. 264, 267; *Blair* v. *Commissioner,* 300 U. S. 5, 9, 10; *Freuler* v. *Helvering,* 291 U. S. 35, 45; *Burnet* v. *Harmel,* 287 U. S. 103.

The decisions of the highest courts of the State of New York have held transfers identical in legal effect to those here in question to be by operation of law. *Terminals Transportation Corp.* v. *State,* 169 Misc. 708, Affirmed 281 N. Y. 889; *Electric Bond and Share Company* v. *State,* 249 App. Div. 371, Affirmed 274 N. Y. 625; *Rockefeller Foundation* v. *State,* 144 Misc. 460, 258 N. Y. Supp. 812; *Phelps-Stokes Estates* v. *Nixon,* 222 N. Y. 93. The court below, recognizing the New York law to be as stated, nevertheless held that such law was neither binding upon it nor controlling.

4. The transfers herein were not taxable under the Federal law and the court below erred in its application of the taxing statute to these transfers in two respects. The court failed to exempt the transfers from the tax pursuant to the provisions of Articles 35 (h) and 35 (r) of Treasury Regulations 71; *U. S.* v. *Merchants National Trust and Savings Bank,* 101 Fed. (2d) 399.

Wherefore, the petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of

this Honorable Court directed to the Circuit Court of Appeals for the Second Circuit commanding that court to certify and to send to this Court for its review and determination on a day certain to be therein named, a transcript of the records and proceedings herein; and that the order of said court entered on January 2nd, 1941 reversing the judgment of the District Court for the Southern District of New York be reversed by this Honorable Court and that petitioners have such other and further relief in the premises as to this Honorable Court may seem just and equitable.

EUGENE J. MORRIS,
Counsel for Petitioners.

STATE OF NEW YORK,
City of New York,
County of New York, ss:

Eugene J. Morris, being duly sworn, says that he is counsel for the petitioners named in the foregoing petition; that he prepared the same and that the allegations thereof are true as he verily believes.

EUGENE J. MORRIS,
Counsel for Petitioners.

Subscribed and sworn to before me this 1st day of April, 1941.

EVELYN R. LAHEY.

Notary Public, Westchester County. Cert. filed in N. Y. Co., No. 623, Reg. No. 1-L-377. Commission expires March 30, 1941.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

POINT I

This Court should take jurisdiction to determine an important question of Federal law heretofore undecided by it.

This Court has never been presented with the question of what constitutes a transfer "wholly by operation of law" within the meaning of Schedule A-9, Title VIII of the Revenue Act of 1926 (as amended by Section 724A of the Revenue Act of 1932) and Treasury Regulations 71, Articles 35 (h) and 35 (r) (See App., pp. 29-32).

The only decisions of this Court, cited by the court below (R. 116), are: *Raybestos Manhattan, Inc.* v. *U. S.*, 296 U. S. 60; *Founders General Co.* v. *Hoey*, 300 U. S. 268; *Burnet* v. *Harmel*, 287 U. S. 103.

These decisions are not directly applicable to the facts in the case at bar but were merely cited to sustain the general propositions of law which the court below believed were enunciated by them. The Second Circuit apparently believed that the decisions in the *Raybestos* and *Founders* cases required the taxing statute to be strictly construed against the taxpayer.

Unlike the case at bar, where the transfers are conceded, both the *Raybestos* and *Founders* cases were concerned with whether or not a "transfer" had occurred within the meaning of the statute. The question in the instant case is whether or not the transfers were effected "wholly by operation of law".

Burnet v. *Harmel, supra,* was cited merely on the general principle of the controlling effect of local law and did not involve the tax statute here in question.

A determination of the question here presented is of the most vital and widespread importance both to the Government and the taxpayers.

The Series C-2 trust estate is but one of over five thousand other trusts of guaranteed certificated mortgages, each of which went through the same type of reorganization as that involved in this case. These other trusts embody approximately 15,000 properties and mortgages and total over $675,000,000 in principal amount. These trusts affect approximately 250,000 certificate holders, a large percentage of whom are persons of only moderate means and dependent for their incomes on these investments. (See Governor Lehman's message to Legislature, Legislative Document 1939, No. 78, and Chapter 745 of the Laws of New York 1933, as amended, Section 1796 of the Unconsolidated Laws of the State of New York.) (Appendix, pp. 34-38.)

Thousands of other transfers legally identical to the subject transfers will be directly affected by a determination of this case.

Point II.

The decision of the Circuit Court of Appeals for the Second Circuit is in direct conflict with that of the Ninth Circuit.

The decision below is in direct conflict with *U. S.* v. *Merchants National Trust & Savings Bank,* 101 Fed. (2d) 399, C. C. A. (Ninth Circuit). In that case a banking and trust company transferred certain stocks and securities as a result of the sale of its entire trust business to the Bank of America of California in accordance with Section 31 of the California Bank Act.

A tax was assessed and collected under the "transfer of legal title" provision of the Revenue Act of 1926, title VIII, Section 300 and Schedule A3, as amended, a provision iden-

tical to that dealt with in the instant case, except that Schedule A-3 concerns itself with transfers of stock and Schedule A-9 with transfers of bonds.

Section 31 of the California Bank Act, above referred to, provided that, upon the approval of the Superintendent of Banks of a sale of a trust business by one bank to another, the stocks and securities comprising such business would be deemed transferred to the purchasing bank as "by operation of law".

The court held that the transfers there in question were effected "wholly by operation of law", and consequently not taxable within the purview of Articles 35 (h) and 35 (r) of Treasury Regulations 71 and, further, that the California State Law was controlling on the question as to what constituted a transfer "wholly by operation of law".

The facts in the case at bar are indistinguishable in principle from the factual situation in the *Merchants* case.

In the instant case, the Second Circuit held that the New York State Law was not controlling upon the Federal Courts as to what constituted a transfer "wholly by operation of law." The Second Circuit further held that the transfers herein were taxable and not within the purview of the exceptions granted by Articles 35 (h) or 35 (r) (R. 116, 117).

The decisions of the Second Circuit in the case at bar and the Ninth Circuit in the *Merchants* case are thus in conflict in three independent respects, any one of which is sufficient to justify this Court in accepting jurisdiction. These conflicts involve the applicability of State law and the interpretation and application to the facts in the case at bar of Articles 35 (h) and 35 (r) of Treasury Regulations 71.

It is submitted that if jurisdiction is accepted by this Court, a favorable determination of any one of these conflicts will require a reversal of the judgment.

A.

THE CONFLICT REGARDING THE APPLICABILITY OF STATE LAW.

The decisions of the Second and Ninth Circuits are diametrically opposed regarding the controlling effect of State Law as to the nature of the transfers. Both courts adopt the doctrine of "necessary implication" as enunciated by *Burnet* v. *Harmel*, 287 U. S. 103, and reach opposite conclusions as to whether the taxing statute and Articles 35 (h) and 35 (r) by necessary implication make their operation dependent upon State law. Proceeding from this divergence of basic construction and applying the law to sets of facts which are legally identical, the Ninth Circuit accepted State law as controlling on the question of whether the transfers were "wholly by operation of law" and the Second Circuit completely rejected it.

B.

THE CONFLICT REGARDING ARTICLE 35 (H) OF TREASURY REGULATIONS 71.

While the facts in the *Merchants* case and in the case at bar are legally identical, within the meaning of Article 35 (h), nevertheless the Ninth Circuit held that Article 35 (h) afforded an exemption and the Second Circuit held to the contrary.

In the *Merchants* case, the Ninth Circuit found that the transfers were from a named resigned trustee to a named substituted Trustee appointed in accordance with the terms of the trust agreement and therefore conformed precisely to the requirements of Article 35 (h) which exempted such transfers from tax. The court found that since the California Banking Act was in existence at the time the trust agreement was executed, the provisions for the substitution

of the Trustees, as contained in the statute, were incorporated in the trust agreement as a matter of law. The Act provided for the substitution of trustees in a manner which brought the transfers within the provisions of Article 35 (h).

Similarly, the facts in the case at bar precisely conform to the facts in the *Merchants* case insofar as the requirements of Article 35 (h) are concerned. There was a transfer from a named resigned trustee (the Mortgage Commission) to a named substituted Trustee (the petitioners herein). The substitution of the Trustees in both cases was pursuant to the statutes of the State in which the transfers occurred.

The Mortgage Commission Act (which incorporated part of the provisions of the Schackno Act by reference, Article VIII, Section 1769 Unconsolidated Laws of New York) was the trust instrument pursuant to which the Mortgage Commission derived all of its powers in the operation of the trust estate for the benefit of the *cestuis que trustents*, the certificate holders.

The substitution of the Trustees was in accordance with the provisions of this trust instrument (the Mortgage Commission Act).

People v. *Title and Mortgage Guaranty Company*, 264 N. Y. 69, 79, 89.

Judge Goddard, holding for the petitioners in the District Court, said:

> "* * * the legal relationship between the Superintendent of Insurance and the Mortgage Commission on one side, and the certificate holders on the other, was that of Trustee and cestui. See People *v.* Title and Mortgage Company, *supra*, at pp. 79 and 89. Plaintiffs therefore took over the securities as Successor

Trustee and under the authority of United States *v.* Merchants National Trust and Savings Bank, *supra*, a transfer to them is not taxable" (R. 102).

C.

THE CONFLICT REGARDING ARTICLE 35 (R) OF TREASURY REGULATIONS 71.

The transfers involved in the *Merchants* case were held to have been effected "wholly by operation of law" within the meaning of Article 35 (r) and therefore exempt. As the petitioners will demonstrate in POINT IV, *infra*, the facts in the instant case are so analagous to those in the *Merchants* case, that the same legal result should properly follow in the case at bar. Notwithstanding, the Second Circuit concluded that Section 35 (r) of Regulations 71 had no application and that the transfers were taxable.

POINT III.

The Circuit Court of Appeals for the Second Circuit has decided a Federal question in conflict with applicable decisions of this Court concerning the controlling effect of State law.

The law of the State of New York is well settled that transfers identical in legal effect with the transfers in the instant case are by operation of law.

Terminals Transportation Corp. v. *State*, 169 Misc. 708, 8 N. Y. S. Supp. (2d) 282, affd. 14 N. Y. Supp. (2d) 493, 281 N. Y. 889 #23;

Electric Bond and Share Company v. *State*, 249 App. Div. 371, Affirmed 274 N. Y. 625;

Rockefeller Foundation v. *State*, 144 Misc. 460, 258 N. Y. Supp. 812;

Phelps-Stokes Estates v. *Nixon*, 222 N. Y. 93.

The Circuit Court of Appeals for the Second Circuit has recognized that:

> "The New York decisions in Terminals & Transportation Corp. *v.* State, 169 Misc. 703, aff'd 257 App. Div. 1028, and Electric Bond & Share Co. *v.* State, 249 App. 371, aff'd 274 N. Y. 625, that transfers similar to those here were by operation of law * * *" (R. 116).

While the taxing statute with which we are here concerned does not expressly make its operation dependent upon State law, Articles 35 (h) and 35 (r) of Treasury Regulations 71 do so by clear and necessary implication.

Burnet v. *Harmel,* 287 U. S. 103;

U. S. v. *Merchants National Trust and Savings Bank,* 101 F. (2d) 399.

The reference in Article 35 (r) to transfers "wholly by operation of law" is explicable only by the law which effectuates the transaction, the legal effect of which is to be determined. Thus, Article 35 (r) contains the general, necessary implication that the law creating the transaction must define and determine its legal effect. Should the nature of the transaction sought to be taxed be determined by Federal law, then, by necessary implication, the Federal law must be adopted to ascertain whether the transfer is "wholly by operation of law". Conversely, as in the case at bar, should the transfer in question be effectuated by State law, then, by necessary implication, the State law must be adopted in determining whether the transfers were effected "wholly by operation of law". This is particularly true where a State law, which is *sui generis,* initiated and by its very terms effectuated the transfer. Once the State law defines the legal effect of what it has accomplished, this determination is controlling on the Federal courts and the re-

maining question is whether the Federal statute taxes the transaction so determined.

Morgan v. *Commissioner*, 309 U. S. 78;
Lang v. *Commissioner*, 304 U. S. 264, 267;
Blair v. *Commissioner*, 300 U. S. 5, 9, 10;
Freuler v. *Helvering*, 291 U. S. 35, 45;
U. S. v. *Merchants National Trust and Savings Bank*, 101 F. (2d) 399;
Legg's Estate v. *Commissioner*, 114 F. (2d) 760;
Dayton & Michigan R. R. Co. v. *Commissioner*, 112 F. (2d) 627;
Leser v. *Burnet* (4th Cir.), 46 F. (2d) 756, 760.

In *Legg's Estate, supra*, the Fourth Circuit has recently summarized the controlling authority concerning the applicability of State law as follows, at page 763:

> "And the application of this rule is not affected by the fact that a question of federal taxation is ultimately involved, for while we look to federal decisions as authoritative in interpreting the federal statute imposing the tax, we look to the law of the state as laid down by its courts in determining whether there has been such a transfer of property as is subject to the tax under that interpretation. 'State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed'" (citing authorities).

Aside from the impossibility of determining the question involved without resorting to and adopting the State law defining the nature of the transfer, Article 35 (r) patently indicates that the statute contemplated the adoption of State law by the very example which it sets forth, i. e. the transfer of stock from decedent to executor. This example definitely contemplates a transfer by operation of the law of a State. Congress does not and probably has no constitutional power

to regulate or provide for the transfer of property at death. Since the example of a transfer "wholly by operation of law" (described in the Regulations) is necessarily a transfer by operation of State law, Article 35 (r) certainly cannot be construed to exclude transfers wholly by operation of State law. The Treasury Department has recognized this and, in fact, ruled that whether or not a given transfer of legal title to shares of stock results wholly from operation of law depends upon the effect given to the transaction by the law of the State in which the transaction occurs.

O. D. 127;
S. T. 5-21-250.

While the Government relied upon *Cliffs Corporation* v. *U. S.*, 103 F. (2d) 77, C. C. A. Sixth Circuit, certiorari denied, 60 S. Ct. 91, to support its contention that the State law is not controlling in this case, the court below tacitly recognized the inapplicability of that case to the facts herein by not even citing the *Cliffs* case in its opinion.

The court, in the *Cliffs* case, recognized the doctrine contended for by the petitioners herein when it said:

> "In many Federal taxing statutes the tax is made to follow at the time the State law creates a legal interest. In such cases the state law will be applied to determine such interest but the Federal Statute determines when and how it shall be taxed * * *."

Congress, in enacting the Rules of Decisions Statute (U. S. Code, title 28, Sec. 725), has specifically provided and indicated its intent that:

> "The laws of the several states, except where the Constitution, treaties, or statutes of the United States otherwise require or provide, shall be regarded as rules of decision in trials at common law, in the courts of the United States, in cases where they apply."

This Court has given effect to that intent by consistently holding that the Federal courts are bound by State law, except where a Federal statute specifically requires or provides otherwise:

Erie R. Co. v. *Tompkins*, 304 U. S. 64;
Vandenbark v. *Illinois Glass Co.*, 61 S. Ct. 347 (not yet reported in United States reporter);
Morgan v. *Commissioner*, 309 U. S. 78;
Lang v. *Commissioner*, 304 U. S. 264, 267;
Blair v. *Commissioner*, 300 U. S. 5, 9, 10;
Dayton & Michigan R. R. v. *Commissioner*, 112 F. (2d) 627.

Point IV.

The transfers herein were not taxable under the Federal law.

Petitioners have maintained in the preceding point that Federal law requires the application of State law in determining the nature of the transfers here in question. However, even assuming that State law is not controlling on the nature of the transfers, they must be held exempt from taxation under the Federal law on any one of two separate and distinct bases. They should have been exempted from taxation under the provisions of Article 35 (h); and similarly under the provisions of Article 35 (r).

A.

The Transfers Fit Precisely Within the Exemption Afforded by Article 35 (h).

To render a transfer not taxable as having been effected "wholly by operation of law", Article 35 (h) requires three essential elements:

(1) a named, resigned Trustee;

(2) a named substituted Trustee, and

(3) each appointed in accordance with the terms of the original trust agreement.

In POINT II under Subdivision B, *supra*, we have established that these essential elements existed in these transfers. It is a necessary corollary, therefore, that the provisions of the statute automatically operate and the court must find the transfers were effected "wholly by operation of law" and are consequently not taxable.

The subject transfers precisely and realistically represent the situation contemplated by the statute. The trust agreement (Mortgage Commission Act) specifically contemplated and anticipated the very succession of trustees which in fact occurred. Thus, the substituted trustee was not only appointed in accordance with the original trust instrument, (the Mortgage Commission Act), but the original trust instrument by its terms contemplated such appointment.

People v. *Title & Mortgage Guarantee Co.* (1934) 264 N. Y. 69;

To the same effect, see
Matter of New York Title & Mortgage Co. (1934) 264 N. Y. 475.

In its opinion, the Court below completely disregarded the application of Article 35 (h) to the instant transfers, although no sound and cogent reason has yet been advanced as to why these transfers are not governed by it.

B.

THE TRANSFERS WERE WHOLLY BY OPERATION OF LAW AND CONSEQUENTLY EXEMPT FROM TAXATION PURSUANT TO ARTICLE 35 (r).

The court below, in arriving at its conclusion that the

taxing statute should be applied strictly to the transfers in suit, said:

> "The Supreme Court construed the Statute imposing the transfer tax literally in *Raybestos-Manhattan Inc.* vs. *United States,* 296 U. S. 60, and *Founders General Corp.* v. *Hoey,* 300 U. S. 268, and was altogether strict in subjecting the transfers to a tax." (R. 116).

While the words just quoted were applicable to the facts in the *Raybestos* and *Founders* cases, this Court, in *White* v. *U. S.,* 305 U. S. 281, has very recently ruled that neither the taxpayer nor the taxing authority should be favored in interpreting taxing statutes but that it is the duty of the courts to decide fairly what the construction of the statutes shall be.

In substantiation of its position regarding the construction to be placed upon the taxing statute, the court cited *Koppers Coal & Transportation Company* v. *U. S.,* 107 F. (2d) 706, decided by the Circuit Court of Appeals for the Third Circuit. It is for this reason that we advert to that case, since neither from the standpoint of the facts nor of the legal principles enunciated does that case have any similarity to the case here presented. There are numerous grounds of distinction between the cases. It is only necessary to refer to the fact that the transfers there presented were specifically taxable under Article 34 (r), a Regulation in no way applicable to or involved in this case. The Court in the *Koppers* case properly so held and aptly stated:

> "Such a transfer of title is within the express language of Schedule A3 of Section 800 and is precisely the example given in Article 34 (r) of Treasury Regulations 71."

The court below considered, therefore, that any voluntary act was sufficient to take the transfers out of the operation

of Article 35 (r) and render them taxable. The two-thirds consent of the certificate holders (required by the statute) was relied upon as the single voluntary act which prevented the transfers from being exempt from taxation as "wholly by operation of law" within the meaning of Article 35(r). The fallacy in taxing these transfers because of the two-thirds consent required by the statute can best be clarified by an analysis of the circumstances surrounding their execution. In order properly to comprehend the significance of this consent, it is necessary to review the manner in which the transfers were effected.

A judicial decree effected the transfers herein taxed after a series of legal steps activated by the machinery of the Mortgage Commission Act.

The Mortgage Commission Act authorized the Mortgage Commission to promulgate a plan of reorganization on its own initiative without any act on the part of the *cestuis*. In the case at bar, the transfers were consummated according to the steps indicated by the statutory machinery; the promulgation of the plan and the application to the court for the approval thereof by the Mortgage Commission; the obtaining of two-thirds consent of the certificate holders in the event that an interlocutory order of approval was made by the court; the making of a final order approving the plan and finally, the appointment and qualification of the Trustees. Upon the qualification of the Trustees, the transfers were automatically effected under and pursuant to the court order approving the plan and title immediately vested in the Trustees without further act or instrument (R. 50-51).

The plan itself provides that:

> "upon the execution of the Declaration of Trust * * * all of the securities against which such mortgage investments have been issued * * * shall immediately vest in the Trustees" (R. 50-51).

The implication is clear from the opinion of the court below that, were it not for the two-thirds consent of the certifi-

cate holders, the transfers herein were effected wholly by operation of law and consequently not taxable. However, when the true nature of this consent is analyzed, it is readily discernible that in no wise did such consent constitute a voluntary act, the effect of which would render the transfers taxable.

The late Mr. Justice Frankenthaler, who was largely responsible for the existing body of law in this field, expressed the belief that certificate holders had no alternative but to approve the plan. He said in *Matter of New York Title and Mortgage Company* (Series N-81), 1[illegible] Misc. 865 at page 866:

> "It may well be that their execution of consents to the proposed plan was due to the fact that they were faced with the alternative of either approving the plan submitted to them or else going without any plan at all."

See also *People* v. *Title & Mortgage Guaranty Co.*, 264 N. Y. 69;

Terminals Transportation Corp. v. *State*, 169 Misc. 708, 8 N. Y. S. (2d) 282, affd. 14 N. Y. S. (2d) 493, 281 N. Y. 889 #23.

See also opinion of Mr. Justice Goddard in the District Court in this case. (R. 99).

A failure to consent to the plan on the part of the certificate holders would have meant that the future administration of the trust estate was completely undetermined. Moreover, the Mortgage Commission could not continue to exist beyond 1939. The certificate holders were, therefore, in a position of uncertainty as to how or by whom their investments would be administered in the event that they rejected the plan. In this connection, it is significant to note that the Mortgage Commission was created as a temporary agency to administer, liquidate and turnover to permanent

liquidating trustees the issues administered by it before its existence terminated. In a speech to the Legislature of the State of New York made on March 21, 1939, regarding the Mortgage Commission, Governor Lehman said:

> "It was necessary for the Commission immediately (upon its creation) to set up an organization * * * to promulgate reorganization proceedings for the appointment of Trustees to act for the certificate holders in the future." (parenthesis ours).

It was clear that if certificate holders were to leave their investments with the Mortgage Commission for even a limited period of time it would have been disastrous and resulted in complete chaos in the future administration of the trust estate. The powers granted to the Mortgage Commission by its trust agreement (the statute) were so limited that it was unable properly to administer a group series organized in the manner of the Series C-2 Issue. Illustrative of one of its limitations was the requirement to obtain court approval upon consent of two-thirds (or failure to dissent of one-third) of the certificate holders for each sale, modification, extension or adjustment made in connection with a mortgage or a property. This trust estate consists of over 100 mortgages and properties involving investments ranging from less than $5000 to over $2,000,000 in principal amount (R. 35-39, incl.). To have required, in each transaction, the consent of two-thirds of 7500 certificate holders scattered widely over the United States would have been totally impractical and prohibitively expensive. When it is realized that the Mortgage Commission, at that time, did not even have the power to satisfy a mortgage, when the full principal plus accrued interest were offered in payment thereof, the utter impossibility of permitting the trust estate to remain with them becomes apparent.

While the Commission administered the Series C-2 issue, a mortgagor actually did attempt to pay off the full principal amount of his mortgage and the payment was refused because of the statutory inability of the Mortgage Commission to accept the same. Thus, the Mortgage Commission was a liquidating trustee unable to liquidate.

The plan of reorganization (R. 33-56, incl.), however, removed all of these limitations and gave to the prospective Trustees a facility and latitude of powers which were required for an orderly and effectual administration and liquidation of the trust estate.

A further analysis of the so-called "choice" of the certificate holders by the two-thirds consent required by the statute reveals that such consent did not cause or insure an approval of the Plan by the court. If, after the required consents had been obtained, the court did not see fit to approve the Plan, it was not required to do so, and conversely, if the certificate holders who had filed consents desired to withdraw them, they could not have done so.

In re New York Title and Mortgage Company (Series N81), 154 Misc. 865, 278 N. Y. Supp. 556.

Furthermore, if the plan were approved in accordance with the statutory machinery, even though one-third of the certificate holders opposed the plan they were bound thereby. Certainly the certificate holders who refused to consent and in fact opposed the plan cannot be said to have performed a "voluntary" act.

Weil v. *President and Directors of Manhattan Company,* 275 N. Y. 238.

The true meaning of the "choice" given to the certificate holders was that they were compelled to accept the plan or to have no plan at all, which essentially means no "choice" at all.

It has repeatedly been held that it is the underlying essence of a transaction which determines its taxability.

See:

Helvering v. *Tex-Pen Oil Co.*, 300 U. S. 481, 493, 57 S. Ct. 569, 81 L. Ed. 755;

Bowers v. *Lawyers Mortgage Co.*, 285 U. S. 182, 188, 52 S. Ct. 350, 76 L. Ed. 690;

United States v. *Phellis*, 257 U. S. 156, 168, 42 S. Ct. 63, 66 L. Ed. 180;

Commissioner of Int. Rev. v. *Schumacher Wall Bd. Corp.*, 9 Cir., 93 F. (2d) 79, 81.

A realistic analysis of this situation may be found in the following excerpt from the Harvard Law Review in its discussion of the opinion below in this case.

> "And indeed a less meticulous concern for the voluntary aspect of the rehabilitation could have been justified by a realization that the required approval is often little more than a reluctant choice over the unattractive alternative of permitting the Mortgage Commission to continue with enforced liquidation. See Terminals & Transportation Corp. *v.* State, 169 Misc. 703, 705, 8 N. Y. S. (2d) 282, 284, 285 (Ct. Cl. 1938), 54 H. L. R. 890, at 891, 892."

Conclusion.

The taxpayers in this case consist of investors of small and moderate means who invested in guaranteed mortgage certificates not as a speculative venture but to conserve their limited assets for future security. They were deluded into believing that impregnable assets and guaranties buttressed their small investments which were legal for trust funds in the State of New York.

The State created agencies to mitigate the losses sustained as a result of the debacle of 1933. These agencies acted as mere conduits to permanent liquidating Trustees,

the ultimate salvaging agents. It is upon this last salvaging operation initiated and effectuated by State law that the Government seeks to impose a further burden. It could not have been the intention of Congress to tax as a voluntary act a transfer resulting through the operation of State machinery designed to retrieve the remnants of their investments.

Respectfully submitted,

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APPENDIX

Jurisdictional Statute.

Title 28, Section 347 (a) U. S. C. A.
(Judicial Code, Section 240 (a), Amended.)

"Certiorari to Circuit Courts of Appeals and Court of Appeals of District of Columbia; Appeal on Writ of Error of Supreme Court from Circuit Courts of Appeals in Certain Cases; for Revenues Not Allowed.

(a) In any case, civil or criminal, in a circuit court of appeals, or in the Court of Appeals of the District of Columbia, it shall be competent for the Supreme Court of the United States, upon the petition of any party thereto, whether Government or other litigant, to require by certiorari, either before or after a judgment or decree by such lower court, that the cause be certified to the Supreme Court for determination by it with the same power and authority, and with like effect, as if the cause had been brought there by unrestricted writ of error or appeal.

(c) No judgment or decree of a circuit court of appeals or of the Court of Appeals of the District of Columbia shall be subject to review by the Supreme Court otherwise than as provided in this section."

Sales and Transfers of Bonds.

Schedule A-9 of Title VIII of the Revenue Act of 1926, as added by Section 724 (a) of the Revenue Act of 1932.

9. Bonds, etc., sales or transfers: On all sales, or agreements to sell, or memoranda of sales or deliveries of, or transfers of legal title to any of the instruments mentioned or described in subdivision 1 and of a kind the issue of which is taxable thereunder, whether made by any assignment in blank or by any delivery, or by any paper or agreement or memorandum or other evidence of transfer or sale (whether entitling the holder in any manner to the benefit

of such instrument or not), on each $100 of face value or fraction thereof, 4 cents: *Provided,* That it is not intended by this title to impose a tax upon an agreement evidencing a deposit of instruments as collateral security for money loaned thereon, which instruments are not actually sold, nor upon the delivery or transfer for such purpose of instruments so deposited: *Provided further,* That the tax shall not be imposed on deliveries or transfers of bonds in connection with a reorganization (as defined in section 112 of the Revenue Act of 1932) if any of the gain or loss from the exchange or distribution involved in the delivery or transfer is not recognized under the income tax law applicable to the year in which the delivery or transfer is made. *Provided further,* That the tax shall not be imposed upon deliveries or transfers to a broker for sale, nor upon deliveries or transfers by a broker to a customer for whom and upon whose order he has purchased same, but such deliveries or transfers shall be accompanied by a certificate setting forth the facts: *Provided further,* That the tax shall not be imposed upon deliveries or transfers from a fiduciary to a nominee of such fiduciary, or from one nominee of such fiduciary to another, if such instruments continue to be held by such nominee for the same purpose for which they would be held if retained by such fiduciary, or from the nominee to such fiduciary, but such deliveries or transfers shall be accompanied by a certificate setting forth the facts: *Provided further,* That where the change of ownership is by transfer of the instrument the stamp shall be placed upon the instrument; and in cases of an agreement to sell or where the transfer is by delivery of the instrument assigned in blank there shall be made and delivered by the seller to the buyer a bill or memorandum of such sale, to which the stamp shall be affixed; and every bill or memorandum of sale or agreement to sell before mentioned shall show the date thereof, the name of the seller, the amount of the sale, and the matter or thing to which it refers. Any person liable to pay the tax as herein provided, or anyone who acts in the matter as agent or broker for such person, who makes any such sale, or who in pursuance of any such sale

delivers any certificate or evidence of the sale of any such instrument, or bill or memorandum thereof, as herein required, without having the proper stamps affixed thereto, with intent to evade the foregoing provisions, shall be deemed guilty of a misdemeanor, and upon conviction thereof shall pay a fine of not exceeding $1,000, or be imprisoned not more than six months, or both.

Article 120 of Treasury Regulations 71.

Basis of tax.—The tax accrues at the time of making the sale or agreement to sell or memorandum of sale, or delivery of, or transfer of the legal title to, the bonds, regardless of the time or manner of the delivery of the bonds or agreement or memorandum of sale. The provisions of articles 34 to 39, both inclusive, of these regulations, relating to sales or transfers of stock, are controlling also in respect of sales or transfers of bonds, in so far as consistent with the provisions of Schedule A-9 and in so far as not inapplicable to the matter of sales or transfers of bonds.

Loans of bonds and the return of bonds loaned are subject to tax.

A bill or memorandum such as provided in article 36, is required in respect of every sale or transfer of a bearer bond.

No tax, however, is imposed upon deliveries or transfers of bonds in connection with a reorganization (as defined in section 112 of the Revenue Act of 1932) if any gain or loss resulting from the exchange or distribution involved in the delivery or transfer is, in whole or in part, not recognized for income tax purposes under the law applicable to the year in which the delivery or transfer is made.

Article 34 (r) of Treasury Regulations 71.

Sales or transfers subject to tax.—The following are examples of transactions subject to the tax:

(r) Upon a merger, the transfer of stock owned by a corporation which is merged into another corporation from the name of the first to the name of the second corporation, such a transfer being effected by the act of the parties and not wholly by operation of law.

Articles 35 (h) and 35 (r).

Sales or transfers not subject to tax.—The following are examples of transactions not subject to the tax:

(h) The transfer of stock from the name of a deceased or resigned trustee to the name of a substituted trustee appointed in accordance with the terms of the original trust agreement, which is a transfer resulting wholly by operation of law.

(r) Transfers of shares or certificates of stock which result wholly by operation of law are not subject to the tax. Transfers of this character are those which the law itself will effect without any voluntary act of the parties, such as transfer of stock from decedent to executor.

Protection of Holders of Guaranteed Mortgages (Schackno Act).

Laws 1933, c. 745.

An Act to provide for the protection of holders of mortgage investments guaranteed by title and mortgage guarantee corporations and investment companies. (L. 1933, c. 745, as amended by L. 1933, c. 780; L. 1934, c. 92; L. 1934, c. 906; L. 1934, c. 909; L. 1934, c. 919; L. 1935, c. 588, in effect April 27, 1935.)

1796. Legislative declaration of fact and policy

1. The legislature hereby declares the existence of a public emergency affecting the health, safety, and comfort of the people requiring the provisions of this act, arising out of the following circumstances. Approximately one billion of dollars in principal amount of real estate mortgage investments, sold, issued, distributed or guaranteed, directly or indirectly, by title and mortgage guaranty corporations or investment companies organized and now existing under the insurance law or banking law, respectively, are now outstanding; and such mortgage investments are widely held by hundred of thousands of investors, a large percentage of whom are persons of only moderate means. As a result of the existing disruption of economic and financial proc-

esses, rental values have declined so sharply that it is impossible in many cases for owners of real estate to meet their obligations on the bonds, mortgages or other security against which mortgage investments have been issued guaranteed by such guaranty corporations, directly or indirectly. Numerous defaults aggregating millions of dollars have occurred in the payment of interest and principal on such mortgage investments and on the bonds, mortgages and other security against which such mortgage investments have been issued; and wide-spread additional defaults are likely to occur therein. Under existing conditions any immediate liquidation of any substantial amount of such bonds, mortgages or other security in respect to which such defaults exist, or the attempt to do so, would so demoralize the general real estate market that there might be realized on such bonds, mortgages or other security substantially less than the face amount thereof and substantially less than would be realized if they were disposed of in an orderly manner over a reasonable period of time. Since the guaranty corporations are obligated to pay the amount of the deficiencies resulting from the liquidation of such bonds, mortgages or other security at less than the face amount thereof, the forced liquidation of the bonds, mortgages or other security would result in such unprecedented demands upon the resources of the guaranty corporations that their resources would be sufficient only to pay a relatively small portion of such demands. The guaranty corporations are not amendable to the federal bankruptcy law; and the holders of mortgage investments cannot avail themselves of the composition provisions of such bankruptcy laws for the settlement of their claims against such corporations in respect of guaranties undertaken by such corporations. The guaranty corporations are subject to control and regulation by the state and to the supervision of the superintendent of insurance or of the superintendent of banks.

It is therefore hereby declared to be essential for the public interest to provide a procedure under which such bonds, mortgages or other security may be liquidated in an orderly manner and under which the assets of the guaranty corporations may be administered and conserved equally and ratably in the interest of holders of mortgage investments.

1801. Reorganization

1. When the superintendent shall have exercised any of the powers granted to him under section three or four of this act, he or the holders of fifteen per centum in principal amount of such mortgage investments (exclusive of any part thereof held by the guaranty corporation which sold such mortgage investments), or a corporation organized under article twelve of the insurance law, as added by chapter four hundred fifty-three of the laws of nineteen hundred thirty-three, may promulgate a plan or agreement, for the readjustment, modification, or reorganization of the rights of all of the holders of such mortgage investments, and the modification, readjustment or liquidation of the bonds, mortgages or other security against which such mortgage investments have been issued. Such plan or agreement shall be deemed to have been duly promulgated when the signatures of the required number of holders of such mortgage investments or their agents duly authorized shall appear on such plan or agreement or upon a written consent setting forth the substance of such plan or agreement. Such signatures may appear on any one copy of the plan, agreement or consent or may appear upon co-nterparts or separate consents if the aggregate signatures shall represent the required number. The names of the promulgators shall appear on the copy or summary to be submitted to the holders of such mortgage investments as herein provided. The superintendent shall thereupon obtain from such guaranty corporation a list of the holders of such mortgage investments. He shall thereupon submit such plan or agreement to all of the holders of such mortgage investments on such list by mailing a copy thereof (or a summary thereof prepared by him) to each such holder or to his duly authorized representative addressed to him, postage prepaid, to the address provided in such list, or if no such address be so provided, then to his last known address. He shall also mail such copy or summary to each other person or corporation known to the superintendent to have an interest which may be affected by the proposed plan or agreement. A copy of the plan or agreement shall be kept by the superintendent at an office of such superintendent avail-

able for public inspection, and he shall take such other steps as he may deem necessary for making the plan or agreement and all notices and facts in connection therewith available to all interested parties. (As amended by L. 1934, c. 919, in effect September 7, 1934.)

1-a. Any holder of a mortgage investment who desires in good faith to promulgate a plan or agreement of reorganization as provided in the preceding subdivision may, upon notice to the superintendent and the appropriate guaranty corporation, apply to the court, which, if satisfied as to the good faith of the applicant, shall order such guaranty corporation to furnish to such applicant a list of the holders of the mortgage investments who would be affected by such plan; but such list shall be retained by such applicant for the purpose specified and shall not otherwise be disclosed or published. (As added by L. 1934, c. 906, in effect August 31, 1934.)

2. The superintendent shall prepare and mail to each such holder and each such other party, either with a copy of such plan or agreement or summary, or at any time subsequent thereto, a notice stating in substance that such plan will be presented to the court as hereinafter provided for, and designating a date, which date shall not be less than twenty days after the mailing of such notice, when such court will pass upon such plan or agreement and hear any objection thereto on the part of any holder of such mortgage investments or such other party as may have an interest therein.

Upon the return date of such notice, the superintendent shall indicate to the court whether or not he approves or disapproves such plan or agreement. The court shall hear the parties interested therein and, if it deem it necessary, may take testimony relative thereto and/or may take proof in affidavit form or through a referee appointed for the purpose as to any fact or circumstance material thereto. If a referee be appointed, he shall make and file a report with the court with all convenient speed. The costs of such reference shall be borne by such of the parties in such amounts as the court shall direct. The court shall there-

upon approve, modify or disapprove such plan or agreement. No such plan or agreement shall become operative unless and until it shall have been approved, in its original or in a modified form by such court, and unless and until the holders of two-thirds in principal amount of such mortgage investments (exclusive of any part thereof held by the guaranty corporation which sold or guaranteed such mortgage investments) or their agent duly authorized, shall have consented to such plan or agreement. (As amended by L. 1935, c. 588, § 1, in effect April 27, 1935.)

3. When any such plan or agreement shall have been so approved by the court and by such two-thirds in principal amount or their agent duly authorized therefor, such plan or agreement shall be binding upon all the holders of such mortgage investment and the guaranty corporation which shall have sold or guaranteed the same; and all the holders of such mortgage investment shall be conclusively deemed to have consented to all of the terms and conditions of such plan or agreement whether or not all of such holders shall actually have consented and whether or not all of them shall have received notice of such plan or agreement or of such hearing as hereinbefore provided. Thereupon such steps shall be taken by the superintendent and all other parties, and all acts shall be done as may be required by such plan or agreement so approved and as may be necessary or desirable for the consum-ation of such plan or agreement.

4. The expenses of the printing and mailing of such plan or agreement or the summary thereof shall be paid as follows: If the plan promulgated be the plan of the superintendent, he shall pay therefor out of any funds which may have come or may come into his possession out of such property. If the plan promulgated be that of the holders of fifteen per centum of such mortgage investments as provided for in this section or if the plan be that of a corporation organized under article twelve of the insurance law, as added by chapter four hundred fifty-three of the laws of nineteen hundred thirty-three then such holders or such corporation shall deposit with the superintendent in advance a sufficient sum of money to pay such expenses, which shall be used by the superintendent for such purposes. If such plan so promulgated by such holders or such corpora-

tion become operative as herein provided the superintendent shall repay to the holders or corporation making such deposit the expenses of such printing and mailing out of any funds which may have come or may come into his possession out of such property. (As amended by L. 1934, c. 919, in effect September 7, 1934.)

1804. Jurisdiction of supreme court

§ 8. The supreme court of the county in which any such guaranty corporation has or had its principal office is hereby vested with jurisdiction and authority to determine the fairness of any plan or agreement which may be promulgated hereunder with respect to any mortgage investments sold or guaranteed by such guaranty corporation and to approve, modify or disapprove the same, provided, however, that where the underlying security or securities, property or properties affected by such proposal or plan is or are located within one county, then the supreme court held in such county shall have such jurisdiction. If a referee be appointed he shall report his determination for confirmation or modification upon such notice as the court shall direct. Such court shall make an order approving, modifying or disapproving such plan or agreement. In the event that the court shall have approved or modified such plan or agreement; and if at the time of the entry of such order the court shall have been satisfied that sixty-six and two-thirds per centum of the holders in principal amount of such mortgage investment or their duly authorized agent have approved such plan or agreement, such order shall recite such fact, and shall thereupon be binding upon all the holders of such mortgage investments and the guaranty corporation which shall have sold or guaranteed them and all of the parties interested therein. If at the time of making such order such percentage of the holders of such mortgage investment shall not have approved of the same, such order shall provide that upon satisfactory proof of the fact that sixty-six and two-thirds per centum of the holders in principal amount of such mortgage investments shall have approved the same, a further order may be entered ex parte approving such plan or agreement, which further order shall be binding upon all the holders of such mort-

gage investments and upon the guaranty corporation which shall have sold or guaranteed the same and upon all other parties interested therein. (As amended by L. 1935, c. 588, § 2, in effect April 27, 1935.)

LAWS OF NEW YORK—BY AUTHORITY.

Chapter 19.

AN ACT declaring the existence of a public emergency, creating the mortgage commission of the state of New York, providing for its powers and duties and providing a method for the relief of distressed holders of mortgage investments

Became a law February 5, 1935, with the approval of the Governor. Passed, on message of necessity, three-fifths being present

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Article I. Existence of emergency.
II. Creation of mortgage commission.
III. Definitions.
IV. Powers and functions of commission.
V. Exercise of limited powers of commission.
VI. Termination of control of commission.
VII. Jurisdiction of supreme court.
VIII. Continuance and consolidation of certain proceedings.
IX. Miscellaneous provisions.

Article I.

Existence of Emergency.

Section 1. Declaration of emergency.

Section. Declaration of emergency. The legislature by joint resolution adopted April twenty-seventh, nineteen hundred thirty-four authorized the appointment of a special committee to investigate and report with respect to emer-

gency and permanent legislation in connection with guaranteed mortgages. Such committee has held public hearings, examined numerous witnesses, and made reports to the second extraordinary session of the legislature of nineteen hundred thirty-four which, among other things, considered emergency legislation for the relief of holders of mortgage investments and the proper administration of the real property or other security underlying the same. The second extraordinary session of the legislature considered the aforesaid reports but failed to pass adequate remedial legislation as recommended therein. The legislature on the eighteenth day of August, nineteen hundred thirty-four, adopted a joint resolution authorizing the continuance by the special committee of its investigation and directing it to make a further report to the legislature. In addition thereto, the governor at the request of the superintendent of insurance appointed a commissioner, under section eight of the executive law, to investigate, among other things, the management and affairs of the insurance department with reference to the operations, conduct, and management of the title and guaranty corporations under its supervision. The commissioner has submitted a final report to the governor.

The legislature has considered the aforesaid reports of its committee and now finds and determines:

There are outstanding many thousands of issues of mortgage investments, issued, sold, distributed or guaranteed directly or indirectly by title or mortgage guaranty corporations organized and/or operating under the insurance law or by companies organized and/or operating under the banking law. Each of these issues is secured by or represents an interest in a single mortgage or by a group of mortgages as the underlying security. The mortgage investments issued by the respective companies in substance provide that the company has assigned and transferred an undivided share or interest in a bond and mortgage, or in a group of bonds and mortgages or in a debt secured thereby, either as a participating interest or as security for an obligation, and that the company is authorized to

receive, collect and sue for the interest and principal of the bonds and mortgages. It is further provided in the form of the greater number of outstanding mortgage investments that the company is authorized to bring foreclosure actions and in many cases the company is authorized to take title to the properties sold thereunder, but in many cases no provision is made for the conferring upon such companies of adequate trust powers to meet any emergency which may be presented and it is doubtful whether under existing law such adequate power can be conferred.

Orders of the supreme court for the rehabilitation or liquidation of many of the companies, subject to the insurance law or banking law as aforesaid, have been made pursuant to the provisions of the insurance or banking law and both the superintendent of insurance and the superintendent of banks have taken possession, as in such laws provided, of the property of such companies and are administering the bonds and mortgages in respect of which such mortgage investments have been issued and/or guaranteed. The companies in rehabilitation or liquidation sold and/or guaranteed in excess of two-thirds of the aggregate principal amount of all outstanding mortgage investments issued by companies organized under or subject to the provisions of the insurance or banking laws. All of the companies in liquidation or rehabilitation are unable to meet their obligations as they mature. No statutory provisions now exist in aid of liquidation of these companies in furtherance of the former section sixty-three, and the present article eleven of the insurance law, and corresponding provisions of the banking law. The holders of such mortgage investments are asserting a great variety of claims against many of these companies, and also allege that the superintendent of insurance and the superintendent of banks are disqualified to represent them because of the conflict in interest between the companies and such holders.

Many thousands of the mortgages with respect to which these companies have issued mortgage securities are in default either in payment of principal, interest or by reason of failure of the owner to pay taxes. The foreclosure of

all of the mortgages in default would ruinously affect owners of real estate generally and the holders of mortgages or other mortgage investments thereon, would aggravate the existing demoralization in real estate values, and inflict irreparable injury not only upon the holders of mortgage investments but upon the people of the state generally. The situation creates an immediate danger to the economic welfare and the vital interest of the community.

The holders of mortgage investments in many thousands of issues are numerous and it has been difficult to obtain concerted action by them. The department of insurance and the banking department are not sufficiently equipped to enable their personnel to efficiently perform their usual duties and properly carry on their normal functions, and, in addition, to perform the burdensome task of representing the holders of mortgage investments of thousands of separate and distinct mortgage issues which require the proper administration of upwards of twenty thousand parcels of real property underlying the same.

Unpaid taxes are accumulating upon many of the properties subject to the mortgages and penalties for nonpayment thereof are accruing in most instances at the rate of ten per centum per annum. The accumulation of unpaid taxes presents a serious problem to the political subdivisions of the state. Many holders of mortgage investments are receiving no income or little income therefrom and they and their families are in want. The present market for such mortgage investments has depreciated to such an extent that few of such mortgage investments can be sold except at great sacrifice and at distress prices.

The legislature, therefore, hereby declares the existence of a public emergency affecting the health, safety and comfort of the people, requiring the enactment of the provisions of this act. Legislation adapted to meet the emergency by conferring power upon a new state agency to act promptly and to encourage, promote and facilitate self-organization by the holders of mortgage investments until such time as there may be established other effective organizations for the administration of their interests is essential to protect the vital interests of the state.

Article II.

Creation of Mortgage Commission.

Section 2. Mortgage commission of the state of New York.

§ 2. Mortgage commission of the state of New York. An agency, to be known as mortgage commission of the state of New York, hereinafter referred to as the commission, is hereby created. Such commission shall be a body corporate and politic. It shall consist of three members who shall be appointed by the governor with the consent of the senate. The governor shall designate one of such members to be the chairman of the commission. The original appointment shall be made so that the term of the chairman shall expire January first, nineteen hundred forty, the term of one member January first, nineteen hundred thirty-nine, and the term of one member January first, nineteen hundred thirty-seven. Their successors shall be appointed for terms which shall expire January first, nineteen hundred forty. Vacancies in the office of the commission occurring otherwise than by expiration of term shall also be filled by the governor with the consent of the senate for the unexpired term. The chairman shall receive a salary of fifteen thousand dollars per year. The other members of the commission shall receive salaries of twelve thousand dollars each per year. Each member of the commission shall be entitled to his expenses actually and necessarily incurred by him in the performance of his duties. Each member of the commission shall devote his entire time to the performance of his duties. The power of the commission shall be vested in and exercised by a majority of the members thereof then in office. The commission may delegate to one or more of its members, or to its officers, agents or employees, such powers and duties as it may deem proper. The governor may remove any member of the commission for inefficiency, neglect of duty, or misconduct in office, giving him a copy of the charges against him and an opportunity of being publicly heard in person and/or by counsel in his own defense, upon not less than ten days' notice. If such member shall be removed, the governor shall file in the office of the

department of state a complete statement of charges made against such member, and his findings thereon, together with a complete record of the proceedings.

* * * * * * *

Article IV.

Powers and Functions of Commission

Section 4. General powers.
5. Limited powers.
6. Functions of commission.*

§ 4. General powers. The commission shall have power:

1. To sue and be sued.

2. To have a seal and alter the same at pleasure.

3. To acquire, hold and dispose of property of all kinds for its corporate purposes.

4. To make by-laws for the management and regulation of its affairs.

5. Subject to the approval of the director of the budget, to use agents, employees and facilities of the state, paying its proper proportion of the compensation or cost, and may use the attorney-general as legal adviser.

6. To appoint and remove agents and employees including counsel, attorneys, engineers, architects, appraisers and accountants and to fix their compensation.

7. To make contracts, and to execute all instruments necessary or convenient.

8. With respect to all bonds, notes or other evidences of indebtedness, mortgages and property referred to in section six hereof, to collect or cause to be collected principal and interest on the bonds, notes or other evidences of indebtedness and mortgages and the rents, income and/or profits of property; to distribute the amount collected after

* So in original. [Does not conform to section heading.]

deduction of expenses of collection and such sums as it deems necessary as reserves for taxes, assessments, water rates and interest, amortization and other obligations with respect to funds borrowed, and to enforce by foreclosure or otherwise any covenant of, or right of action arising out of, the bond, note or other evidences of indebtedness or mortgage.

9. To acquire title to or possession of property covered by a mortgage from the mortgagor or owner by voluntary conveyance or transfer, and/or the rents, income and/or profits therefrom by assignment, or by collection thereof.

10. To purchase at foreclosure or other judicial sales property which constitutes the underlying security for any mortgage under the jurisdiction of the commission and to take title thereto for the benefit of all holders of mortgage investments interested in such mortgage; and on such purchase to apply the amount due on the bond and/or mortgage on the purchase price bid.

11. To operate, manage and rehabilitate by alteration, repair or otherwise any and all properties which are the underlying securities for any mortgage under its jurisdiction and/or to appoint an agent or agents to operate, manage or rehabilitate the same, or to lease the same or any part thereof for a period not exceeding five years, upon such terms and conditions as the commission may deem proper.

12. Where any mortgage under the jurisdiction of the commission confers upon the mortgagor the right to have any property released from the lien thereof upon the making of a specified payment, to execute and deliver such release upon receipt of such payment.

13. To support or oppose in whole or in part any plan of reorganization or other plan, proposal or agreement promulgated by any person, firm or corporation.

14. To withdraw any proposal or to abandon any plan, before approval by the court except in the case of a plan proposed under section ten of this act.

15. To exercise the power conferred on the superintendent of insurance and/or the superintendent of banks by section six of chapter seven hundred and forty-five of the laws of nineteen hundred thirty-three, in connection with a plan or agreement, as therein defined, for the readjustment, modification or reorganization of the rights of all of the holders of mortgage investments, and the modification, readjustment or liquidation of the bonds, mortgages or other security upon which such mortgage investments have been issued.

16. To terminate its functions in respect of and to surrender any bond or mortgage or property held by it to a person or persons or corporation representing all the holders of mortgage investments in respect thereof.

17. To negotiate with agencies of the federal government and the state of New York and any other public and/or private corporation, individual or association for relief, by loan or otherwise, of holders of mortgages and/or mortgage investments. To accomplish this purpose it may organize a subsidiary corporation or corporations having capital stock along such lines as shall make such corporation or corporations eligible to receive loans from agencies of the federal government and/or the state of New York and/or any other public and/or private corporation, individual or association, and to lend moneys so obtained upon the security of mortgages and/or mortgage investments, the voting stock in such corporation to be purchased and held in its entirety by the commission. Any such subsidiary corporation shall be deemed organized when the commission shall have filed in the office of the secretary of state the certificate of authority prescribing the name, plan, purposes, powers and form of organization of such corporation, the amount of the authorized capital stock and the number and par value of the shares of which it is to consist. No filing, recording fee or tax shall be required for organizing such subsidiary corporation. Should a loan be made to a holder or holders of mortgage investments, it shall only be made to such as shall have acquired them prior to March fifth,

nineteen hundred thirty-three, or to those who subsequently received them by inheritance from such holders.

18. To act as attorney in fact, trustee, substitute trustee, or successor trustee, for holders of mortgage investments, by appointment of the court, election of the holders of mortgage investments or otherwise, on such terms and conditions as it shall impose, and may, in its discretion, so act without the acceptance of fees or other compensation.

19. To organize a subsidiary corporation or corporations wholly owned and controlled by it and with trust powers only, to act as attorney in fact, trustee, substitute trustee or successor trustee for holders of mortgage investments by appointment of the court, election of the holders of mortgage investments or otherwise. Such corporation may, in its discretion, act without the acceptance of fees or other compensation. Such subsidiary corporation or corporations shall be deemed organized when the commission shall have filed in the office of the secretary of state a certificate of authority prescribing the name, plan, purposes, powers and form of organization of such corporation, the amount of the authorized capital stock and the number and par value of the shares of which it is to consist. No filing, recording fee or tax shall be required for organizing such subsidiary corporation, nor shall such corporation be subject to the payment of any income or franchise taxes.

20. The commission may require all persons, firms, corporations or guaranty corporations selected as its agents to furnish bond or security satisfactory to it for the faithful performance of their duties.

21. The commission may in its discretion initiate and carry on such studies, investigations and researches as will assist it in recommending the enactment of appropriate legislation designed to increase public confidence in real estate and mortgage investments, lessen the burden of taxation now resting on real property, and provide proper supervision, regulation and control of the issuance, guaranty, sale and distribution of mortgage investments.

22. To do any and all things requisite, necessary or incidental to the exercise of the powers conferred upon the commission by this act.

§ 5. Limited powers. The commission shall have the following limited powers, with reference to mortgages, mortgage investments and real estate under its jurisdiction:

1. To extend the date of maturity of any bond, note, other evidence of indebtedness or of any mortgage, or the date of payment of the entire or any part of any instalment of principal thereof due under a mortgage covering real property under its jurisdiction.

2. To waive, reduce the rate, and/or extend the time of payment of interest payable under any bond, note, other evidence of indebtedness or under any mortgage;

3. To borrow funds for any of the following purposes:

(a) to pay taxes, assessments or water rates and penalties thereon, fire, rent, liability, workmen's compensation and/or other appropriate insurance, and to buy or redeem tax liens and transfers thereof;

(b) to preserve or rehabilitate by alteration, repair, or otherwise the property covered by a mortgage or acquired upon foreclosure or otherwise;

(c) to pay foreclosure costs and expenses or an amount approximating such costs and expenses as consideration for a conveyance from the mortgagor;

(d) to pay any item of cost or expense not particularly specified incident to the maintenance, preservation or protection of any of the several properties being administered by it;

4. To execute, and deliver, in connection with any funds borrowed pursuant to the provisions of sub-section three of this section, its promissory note or other evidence of indebtedness, chargeable to and payable only out of the property for whose benefit such loan was made, and securing the same by a lien upon the mortgage or property affected thereby prior and superior to the right or interest therein of all holders of mortgage investments covering said property, and also to execute and deliver any and all agreements or instruments of subordination, or otherwise, deemed necessary or proper or required to establish the priority of such lien.

5. To sell or exchange any bond, note, other evidence of indebtedness or any mortgage or property acquired by it and/or to release one or more parcels from the lien of any mortgage upon such terms and conditions and for such consideration as the commission may deem proper, including the right to accept as part of the purchase price a mortgage not exceeding sixty-six and two-thirds per centum of the purchase price, payable in not more than ten years;

6. To formulate and carry into effect any plan of reorganization in respect of any bond, note, other evidence of indebtedness and mortgage or property or group thereof acquired by it not otherwise specifically provided for by this section;

7. To exchange the whole or part of any bond or mortgage or property acquired by it, for securities issued or guaranteed by any public corporation now or hereafter organized pursuant to an act of congress and in addition to such securities or guarantees, if obtainable, a junior mortgage to cover any unfunded balance and, if it so chooses to avail itself of any provisions of any act of congress or of any regulation of any department of the federal government with respect of any matter within the jurisdiction of the commission.

8. The foregoing enumerated powers shall be deemed in addition to and not in limitation of the general powers conferred by this act.

* * * * * * *

Article V.

Exercise of Limited Powers of Commission.

Section 7. Procedural requirements.

§ 7. Procedural requirements. 1. Whenever the commission shall make any proposal or plan to exercise any of the limited powers specified in section five hereof (except in the exercise of the powers granted by subsection twelve of section four hereof or in subsection four of this section) it shall file a copy of such proposal or plan with the clerk

of the court and shall prepare and mail to each holder of a mortgage investment of the issue concerned addressed by registered mail to him, postage prepaid, to his last address as the same appears on the records of the commission or on the records of the superintendent of insurance and/or of banks, or on the records of the guaranty corporation which issued or guaranteed the mortgage investment of such holders, and if no address of any such holder shall appear on such records, then to his last known address, a summary of such proposal or plan together with a notice stating in substance that such proposal or plan will be presented to the court, and designating a date, which date shall be not less than thirty days after the mailing of such notice when such court will pass upon such proposal or plan and hear any objection thereto on the part of any holder of a mortgage investment. Such notice shall also be published by the commission once, at least twenty days before said date, in a daily newspaper of general circulation published in the county where such hearing is to be had and if no such daily newspaper is published in such county, then such notice shall be published in such other newspaper of general circulation as may be published in said county. Such summary and notice shall also be mailed to any agency of the state or federal government or to any corporation, association or individual, which or who shall have notified the commission that it is pledgee of, or has a lien upon, or an interest in any mortgage investment of the issue concerned. Upon the return date of such notice or any adjourned date or dates thereof, the court shall hear the parties interested therein and may accept proof in affidavit form or otherwise as to any facts and circumstances material thereto. The court upon proof by affidavit that the provisions hereof with respect to mailing and publishing have been fully complied with shall thereupon approve, modify or disapprove such proposal or plan, but in no event shall any such proposal or plan or modification thereof be approved by the court unless the court deems such proposal or plan fair and equitable to the holders of mortgage investments or if written dissent therefrom, duly executed and acknowledged, shall be filed with the clerk of the court prior to such return date, or prior to such other date as may be fixed by the court, by

the holders in the aggregate of more than thirty-three and one-third per centum of the face amount of mortgage investments affected by such proposal or plan. All holders of mortgage investments who have not dissented from the proposal or plan in the manner provided by this section shall be conclusively deemed to have assented thereto. Such proposal, plan or modification thereof shall become effective immediately upon the entry of the order approving the same.

Whenever the plan of reorganization involves any of the acts set forth in sub-sections five, six or seven of section five hereof, (except when the commission exercises any of the powers granted by sub-section twelve of section four hereof or sub-section four of this section) such plan shall contain a provision in respect of dissenters thereto, to the effect that adequate protection will be provided for the realization by them of the value of their mortgage investment as of the date of the promulgation of the plan by such method as will in the opinion of the court, under and consistent with the circumstances of the particular case, be equitable and fair to them.

2. No dissent from any such proposal or plan may be filed by the holder of a mortgage investment whose evidence of such investment has appearing on the face thereof a notation that the commission is authorized without qualification or reservation to represent the holder thereof. Proof of such a notation of authorization shall be made by affidavit of an officer or employee of the commission that such evidence of mortgage investment bears such notation, and upon the filing of such affidavit, any dissent filed by the holder of such mortgage investment shall be disregarded. In case the notation discloses a qualification, reservation, right, or interest in a person, firm or corporation other than the holder, such person, firm or corporation may file dissent to the extent of his or their respective interests.

3. The appellate court to which an appeal is taken by any dissenting holder from any action by the court pursuant to this section shall have the right to impose upon the appellant as part of the costs of the appeal, reasonable fees of counsel for the respondent, and such appellate court may

also, in its discretion, require bond therefor before entertaining any such appeal.

4. The commission may upon such notice, if any, as is hereinafter provided, apply to a judge or court for an order granting authority to sell, out of a group of bonds, notes or other evidences of indebtedness, and mortgages or properties with respect to which mortgage investments are outstanding, one or more of such bonds, notes or other evidences of indebtedness, and mortgages or properties, or to extend the date of maturity of one or more of such mortgages or the date of payment of the entire or any part of any instalment of principal thereof, or to reduce the rate of interest and/or extend the time of payment of interest payable under any such bonds, notes or other evidences of indebtedness, or of any mortgage, or to release one or more parcels from the lien of any mortgage, or to exchange any such bonds, notes or other evidences of indebtedness and mortgages for securities issued or guaranteed by any public corporation now or hereafter organized pursuant to an act of congress and such authority may be granted and such order made if the court finds (1) that the bonds, notes or other evidences of indebtedness and mortgages or properties to which the application refers have a total face value (taking the properties at the principal amount of the mortgages to which the properties were formerly subject) of less than fifty thousand dollars, and constitute less than five per centum of the total face amount of mortgage investments outstanding in respect of such group issue; and (2) that the total face value of bonds, notes or other evidences of indebtedness and mortgages and properties (taken as aforesaid) with respect to which similar applications have been previously made by the commission, and granted, together with the face value of the bonds, notes or other evidences of indebtedness, and mortgages and properties to which the application refers are in the aggregate not in excess of ten per centum of the face amount of mortgage investments outstanding in respect of such group issue.

The commission may also upon such notice, if any, as is hereinafter provided apply at any time for authority to sell for cash any property, where the price is not less than the

face amount of the guaranteed mortgage to which said property was formerly subject, together with interest accrued and foreclosure costs and expenses.

The aforesaid applications may be made ex parte unless any holder of a mortgage investment or committee of such holders shall, in advance, have filed with the commission a request for notice of any such application, affecting any particular series of mortgage investments in which he or they may have an interest, in which event the commission shall give by registered mail to such holder of a mortgage investment or committee ten days' written notice of the application.

5. Notwithstanding any of the provisions of this section, the commission may without application to the court exercise with respect of any bond, note or other evidence of indebtedness, mortgage or property any power possessed by the guaranty corporation at the time of the entry of the order of rehabilitation, in respect of such bond, note or other evidence of indebtedness, mortgage or property.

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Article VII.

Jurisdiction of Supreme Court.

Section 11. The court to pass upon proposal or plan.
12. The commission may designate director of corporation upon reorganization.*
13. Appointment of commission as trustee.
14. Enlargement of powers of trustees.
15. Reclamation of property.
16. Appointment of commission as receiver.
17. General powers of court.

§ 11. The court to pass upon proposal or plan. The supreme court for the county in which a guaranty corporation has or had its principal office is hereby vested with jurisdiction and authority to determine the fairness of any proposal

* So in original. [Does not conform to section heading.]

or plan which may be promulgated hereunder with respect to any mortgage investment guaranteed by such guaranty corporation and to approve, modify or disapprove the same, provided, however, that where the underlying security or securities, property or properties affected by such proposal or plan is or are located within one county, then the supreme court held in such county shall have such jurisdiction. In considering such proposal, the court or a referee appointed by the court shall determine whether such proposal or plan is fair, reasonable and equitable to the holders of mortgage investments and whether it meets their best interests. If a referee be appointed he shall report his determination for confirmation or modification upon such notice as the court shall direct. Nothing herein contained shall affect the jurisdiction of the supreme court held in any county with respect to any proceeding pending in such court at the time this act takes effect.

§ 12. The commission may designate a director of corporation upon reorganization. In passing upon any proposal or plan or agreement proposed under this act or under chapter seven hundred forty-five of the laws of nineteen hundred thirty-three, which proposes in whole or in part the formation or appointment of a corporation to represent the holders of mortgage investments of any issue, the court shall, upon the application of the commission, require the proposal or plan to provide that the commission shall have the right to designate one of the directors of such corporation, and his successors.

§ 13. Appointment of commission as trustee. In passing upon any proposal or plan or agreement proposed under this act or under chapter seven hundred forty-five of the laws of nineteen hundred thirty-three, the court may appoint the commission to act as trustee, substitute or successor trustee.

§ 14. Enlargement of powers of trustees. Whenever pursuant to the provisions of section nine of this act, a trustee or trustees, substitute or successor trustee or substitute or successor trustees shall be appointed by the court, the court

may, in its discretion, from time to time, confer upon such trustee or trustees all or any part of the powers granted to the commission under section five of this act, and such trustee or trustees shall exercise such powers in accordance with section seven of this act.

§ 15. Reclamation of property. The court shall also have jurisdiction, upon petition of the commission, and upon such notice as it shall deem proper, and after hearing thereon, to direct any person, firm or corporation in possession of property the right to the possession of which is by this act vested in the commission, to deliver and surrender such property to the commission.

§ 16. Appointment of commission as receiver. In any action commenced for the foreclosure of a mortgage which the commission is administering or which is being administered under its direction, or for the foreclosure of a mortgage junior thereto, whether such action is instituted by the commission or any other person, firm or corporation, the court may, whenever it is proper to appoint a receiver or to extend a receivership, appoint the commission as receiver, without bond, either upon the court's own motion, or upon motion of the commission. The commission shall not receive any compensation as receiver but shall be reimbursed for its expenses.

§ 17. General powers of court. The court shall also have jurisdiction to make orders in respect of any and all matters as to which court action is hereby provided and to make orders upon the petition of the commission, or of any other interested party, to enforce any provision of this act.

Article VIII.

Continuance and Consolidation of Certain Proceedings.

Section 18. Proceedings under chapter seven hundred forty-five of the laws of nineteen hundred thirty-three expressly permitted.
19. Consolidation of proceedings.

§ 18. Proceedings under chapter seven hundred forty-five of the laws of nineteen hundred thirty-three expressly per-

mitted. Except to the extent provided in section six, this act shall not supersede chapter seven hundred forty-five of the laws of nineteen hundred thirty-three and this act shall not operate to prevent the promulgation and approval of a proposal or plan pursuant to the provisions of section six, seven, seven-a and eight of chapter seven hundred and forty-five of the laws of nineteen hundred thirty-three, as amended, for the adjustment, modification or reorganization of the rights of all the holders of a mortgage investment, and modification, readjustment or liquidation of the bonds, notes or other evidences of indebtedness, mortgages or other securities against which such mortgage investment has been issued. Whenever a proposal or plan of reorganization shall have been approved by the court and shall have become operative pursuant to the provisions of said chapter seven hundred and forty-five, which proposal or plan shall vest either title, possession or control over any property of which the commission shall be in possession, in any other person, firm or corporation, the commission shall terminate its functions in respect of such property and surrender the same as provided in said proposal or plan. The commission shall be entitled to receive upon such surrender reimbursement of all its expenses theretofore incurred by it in respect thereof, as approved by the court, and for which it has not been therefor reimbursed.

Whenever the commission shall promulgate a proposal, plan or agreement pursuant to section six of chapter seven hundred and forty-five of the laws of nineteen hundred thirty-three, it shall specify in such proposal, plan or agreement that the same is promulgated pursuant to chapter seven hundred and forty-five of the laws of nineteen hundred thirty-three, and the provisions of said chapter seven hundred and forty-five shall apply to all further proceedings in respect of such proposal, plan or agreement and the provisions of section seven of this act shall be inapplicable thereto.

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Article IX.

Miscellaneous Provisions.

Section 23. Powers of fiduciaries.
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25. Liabilities not discharged.
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27. Accounting by the commission.
28. Transfer of records.
29. Continuity of jurisdiction.
30. Commission may institute and/or intervene in court proceedings.
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32. Inconsistent provisions in other acts superseded.
33. Separability.
34. Duration of emergency.*
35. Effective date.

§ 23. Powers of fiduciaries. An executor, administrator, trustee, guardian, committee of an incompetent, or other person, including any official of the state or any political subdivision thereof, holding trust funds, who has lawfully invested any trust funds in or lawfully holds any mortgage investments may deposit the same with the commission and may authorize the commission by such deposit, or by letter of authority, power of attorney, or otherwise, to act for him in all respects in connection therewith or may assent to any proposal or plan submitted to the court under the provisions of this act or chapter seven hundred forty-five of the laws of nineteen hundred thirty-three, and do such acts as may be required by such proposal or plan or may be necessary or desirable for the consummation of such proposal or plan or such acts as may be required to assist the commission to effectuate any of the purposes for which it is organized or any of the acts which it is empowered to perform, may accept in exchange for such mortgage investments, and hold the same as legal investments, any securities or obligations, secured or unsecured, issued pursuant to such pro-

* So in original. [Does not conform to section heading.]

posal or plan as approved or modified by the court; and for such deposit or authorization, or the acts of the commission thereunder, the execution of such instruments, the doing of such acts, and/or the acceptance or holding of such securities or obligations, such executor, administrator, trustee, guardian, committee of an incompetent or other person shall not be subject to any liability whatsoever. Subject to the approval of the court having jurisdiction over the accounting of such fiduciary, any fiduciary may borrow money for the account of the estate being administered by him, upon the security of any mortgage investment.

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§ 34. Duration of the emergency. This act shall remain in force and effect until January first, nineteen hundred forty. No action taken or obligation or liability incurred or undertaken pursuant to the provisions of this act, however, shall become invalid after such date. Any mortgages or property possessed by the commission on January first, nineteen hundred forty, shall thereafter be taken over by the superintendent of insurance if the mortgage investments to which the same refer were issued by a guaranty corporation organized under the insurance law or by the superintendent of banks, if the mortgage investments to which the same refer were issued by a corporation organized under the banking law.

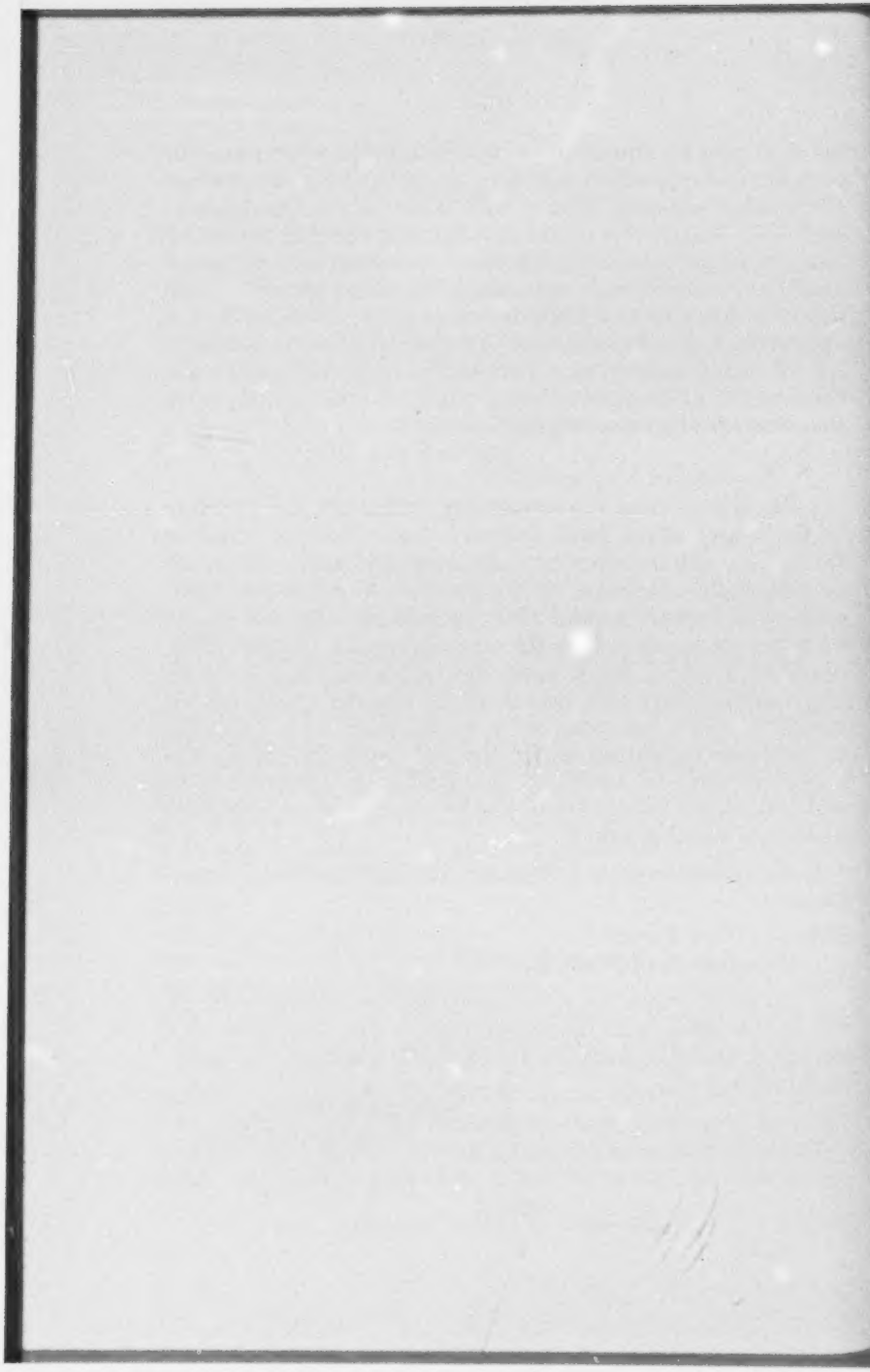
§ 35. Effective date. This act shall take effect immediately.

STATE OF NEW YORK,
Department of State, ss:

I have compared the preceding with the original law on file in this office, and do hereby certify that the same is a correct transcript therefrom and of the whole of said original law.

EDWARD J. FLYNN,
Secretary of State.

(3604)



APR 30 1941
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 916

FRANK L. WEIL, WILLIAM E. RUSSELL and RAYMOND J. SCULLY, as Trustees under a declaration of trust dated April 7th, 1936 and a plan of reorganization of Series C-2 mortgage investments approved by an order of the Supreme Court of the State of New York entered on the 16th day of January, 1936,

Petitioners,

vs.

THE UNITED STATES OF AMERICA.

BRIEF OF THE MORTGAGE CORPORATION OF NEW YORK, *AMICUS CURIAE*, FILED IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

HAROLD L. SMITH,
JOHN F. CASKEY,
Attorneys for The Mortgage Corporation of New York, amicus curiae.

CURTISS ELY FRANK,
RICHARD B. DARRAGH,
Of Counsel.

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Supreme Court of the United States

OCTOBER TERM, 1940.

FRANK L. WEIL, WILLIAM E. RUSSELL and RAYMOND J. SCULLY, as trustees under a declaration of trust dated April 7, 1936 and a plan of reorganization of Series C-2 mortgage investments approved by an order of the Supreme Court of the State of New York entered on the 16th day of January, 1936,

Petitioners,

against

THE UNITED STATES OF AMERICA.

No. 916

BRIEF OF THE MORTGAGE CORPORATION OF NEW YORK, *AMICUS CURIAE*

This brief is submitted (with the written consent of the petitioners and of the Solicitor General of the United States) on behalf of The Mortgage Corporation of New York, *amicus curiae,* in support of a petition in the above entitled action filed by petitioners hereinabove named for writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

The Mortgage Corporation of New York was organized by the Superintendent of Insurance of the State of New York in August, 1933, at the time he took over Bond and Mortgage Guarantee Company in rehabilitation, as part of a plan approved by the New York Supreme Court

for the administration of approximately $300,000,000 of certificated mortgages then under guarantee by the latter company. All of the stock of The Mortgage Corporation of New York was issued to the Superintendent of Insurance as rehabilitator of Bond and Mortgage Guarantee Company and is now held by him as liquidator of such company.

The Mortgage Corporation of New York is presently trustee of a large number of certificated mortgages securing corporate bonds which in all probability will be subject to tax if the decision of the United States Circuit Court of Appeals in the above entitled action remains in full force and effect. The bonds involved in the instant action are corporate bonds originally guaranteed by New York Title and Mortgage Company, a company engaged in the same kind of business as was Bond and Mortgage Guarantee Company, and were ultimately assigned to the petitioners as trustees. In the case of The Mortgage Corporation of New York, the bonds were originally guaranteed by Bond and Mortgage Guarantee Company and were ultimately assigned to The Mortgage Corporation of New York as trustee.

We shall not attempt to duplicate the material contained in the brief of petitioners, which adequately sets forth the reasons for granting a writ of certiorari herein. We simply wish to emphasize the importance of the problem presented by this litigation. The action brought by petitioners for refund of the tax was in the nature of a test case. Altogether, in metropolitan New York City alone, there are close to $1,000,000,000 of corporate bonds secured by certificated mortgages, with respect to which the tax on the transfer to trustees is or may be controlled by the final decision in this

case (N. Y. L. 1933, c. 745; p. 32 of petition for writ of certiorari and brief).

We agree with petitioners that (1) the Circuit Court of Appeals for the Second Circuit has decided an important question of federal law which has not been, but should be, settled by this court, (2) the decision of the Circuit Court of Appeals for the Second Circuit in this case is in conflict with the decision of the Circuit Court of Appeals for the Ninth Circuit in *United States* v. *Merchants Nat. Trust & Savings Bank,* 101 F. (2d) 399 (9th Cir.), and (3) the Circuit Court of Appeals for the Second Circuit has decided a federal question in conflict with applicable decisions of this court concerning the controlling effect of State law. *Terminals & Transportation Corp.* v. *State of N. Y.,* 169 Misc. 703, 8 N. Y. S. (2d) 282, aff'd 257 App. Div. 1028, 14 N. Y. S. (2d) 493, motion for leave to appeal denied 281 N. Y. 889 #23; *Electric Bond & Share Co.* v. *State of N. Y.,* 249 App. Div. 371, aff'd 274 N. Y. 625; *Rockefeller Foundation* v. *State of N. Y.,* 144 Misc. 460, 258 N. Y. Supp. 812; *Lang* v. *Commissioner,* 304 U. S. 264, 267; *Blair* v. *Commissioner,* 300 U. S. 5, 9, 10; *Freuler* v. *Helvering,* 291 U. S. 35, 45; *United States* v. *Merchants Nat. Trust & Savings Bank,* 101 F. (2d) 399, 401 (9th Cir.); *Dayton & Michigan R. Co.* v. *Commissioner,* 112 F. (2d) 627 (4th Cir.).

We submit that the transfers here in question, which resulted directly from the failure of the mortgage guaranty companies in New York and were required under the statutory system created by the Legislature of the State of New York to salvage the investments of hundreds of thousands of persons in certificated mortgages, were not the result of "voluntary acts" of the certificate holders. We believe that

if the petition for writ of certiorari is granted, a full consideration of the circumstances will conclusively demonstrate that the transfers in question were in every real sense transfers resulting wholly by operation of law and hence not subject to tax (Article 35(r) of Treasury Regulations 71).

We further submit that the transfers were in substance from the name of a resigned trustee (Mortgage Commission of the State of New York, which was created and terminated by statute) to the name of a substituted trustee (petitioners) appointed in accordance with the terms of the original trust agreement (the statutes creating the trusts), and hence were transfers resulting wholly by operation of law and not subject to tax (Article 35(h) Treasury Regulations 71). *Matter of New York Title & Mortgage Co.*, (Series C-2, etc.), 257 App. Div. 19 (motion to dismiss appeal granted 281 N. Y. 829), where the court said (p. 25):

> "The powers possessed by the trustees, however, could not be greater than those which the Schackno Act permitted them to have, for they are purely statutory trustees."

In *Weil* v. *President, etc. of Manhattan Co.*, 275 N. Y. 238, the court held that petitioners are "purely statutory trustees possessing only such power and authority as is conferred upon them by statute [the Schackno Act]". See also *Mittlemann* v. *President, etc. of Manhattan Co.*, 248 App. Div. 79, aff'd 272 N. Y. 632; *Rabinowitz* v. *President and Directors of the Manhattan Co.*, 275 N. Y. 453; *Hurdman* v. *Kelly*, 254 App. Div. 368.

CONCLUSION

It is therefore respectfully submitted that the petition for writ of certiorari should be granted.

HAROLD L. SMITH,
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CURTISS ELY FRANK,
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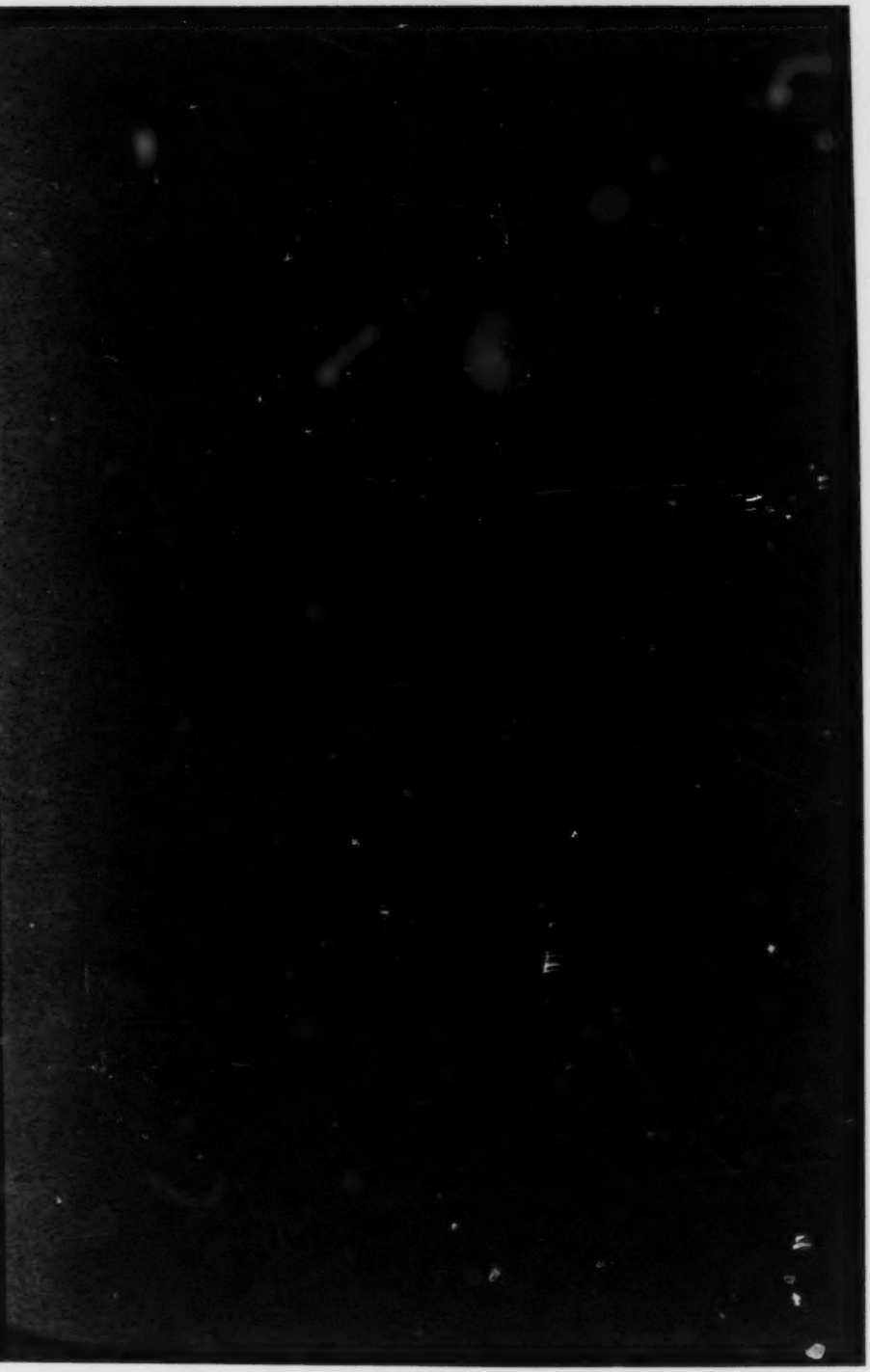

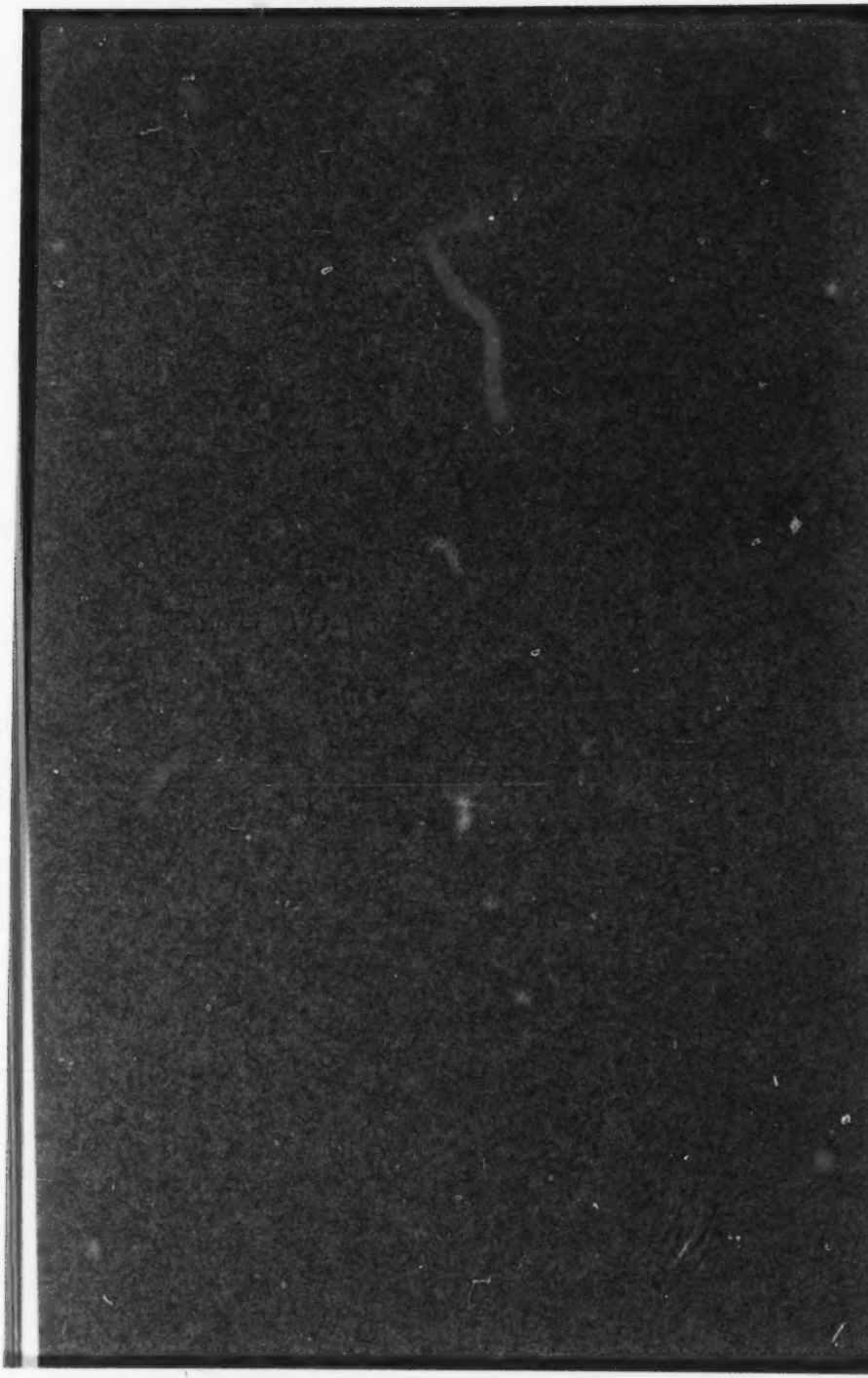

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 916

FRANK L. WEIL, WILLIAM E. RUSSELL AND RAYMOND J. SCULLY, AS TRUSTEES UNDER A DECLARATION OF TRUST DATED APRIL 7, 1936, AND A PLAN OF REORGANIZATION OF SERIES C–2 MORTGAGE INVESTMENTS APPROVED BY AN ORDER OF THE SUPREME COURT OF THE STATE OF NEW YORK, ENTERED ON THE 16TH DAY OF JANUARY, 1936, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 96) is reported in 30 F. Supp. 349. The opinion of the Circuit Court of Appeals (R. 111) is reported in 115 F. (2d) 999.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 2, 1941. (R. 118.) The petition for a writ of certiorari was filed April 2, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Holders of securities voluntarily approved a plan of reorganization whereby certain underlying bonds were transferred to trustees for the benefit of the security holders.

The question presented is whether the transfer is subject to the stamp tax on the transfer of bonds or is exempt therefrom under Treasury Regulations 71, Article 35, as a transfer wholly by operation of law.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the statute and regulations are set out in the Appendix, *infra*, pp. 7–9.

STATEMENT

Prior to August 4, 1933, the New York Title and Mortgage Company engaged in the mortgage guarantee business, selling to investors certificates, guaranteed by the company, representing undivided interests in bonds and mortgages owned by the company. Among its issues was Series C–2 First Mortgage Participation Certificates (R. 3).

On August 4, 1933, by order of the Supreme Court of New York entered pursuant to Article XI of the Insurance Law of New York, the company transferred its property, including the bonds underlying the Series C–2 certificates, to the Superintendent of Insurance of New York, who took possession as Rehabilitator.[1] On May 16, 1935, the State Mortgage Commission, which had been created pursuant to Chapter 19 of the Laws of 1935 of the State of New York, took over the properties of the company from the Superintendent of Insurance (R. 4–5). On July 16, 1935, an order of liquidation was entered by the Supreme Court (R. 4).

Subsequently the Mortgage Commission, proceeding under the "Shackno Act",[2] promulgated a "plan for the readjustment, modification or reorganization of the rights of all the holders of mortgage investments represented by Series C–2 First Mortgage Participation Certificates, issued and guaranteed by" the company (R. 33). On October 10, 1935, the Supreme Court of New York entered an interlocutory order (R. 26) which recited that the modified plan would be approved upon satisfactory proof (required by the statute) that 66⅔% of the holders of Series C–2 mort-

[1] Insurance Law of New York, Sections 401, 402 (2).

[2] Section 5 (6) of the Mortgage Commission Act, and Chapter 745 of the Laws of 1933 of the State of New York.

gage investments approved the plan (R. 32). Such a showing was made and on January 16, 1936, the Supreme Court entered a final order approving the plan.

On April 6, 1936, a final order appointing the trustees under the plan was entered by the Supreme Court of New York (R. 93). The bonds underlying the Series C–2 certificates were thereupon transferred by the Mortgage Commission to the trustees (R. 5–6). It is this transfer which is in controversy. Upon it the Government assessed and collected a stamp transfer tax of $6,361.64 (R. 6).[3] The tax was paid under protest, claim for refund was duly filed and rejected, and this action was instituted (R. 7).

The District Court held that the tax was improperly assessed and collected, on the ground that the transfer was accomplished by operation of law and was therefore within the exemption accorded by Article 35 (r) of Treasury Regulations 71 (R. 96–98). The Circuit Court of Appeals reversed (R. 118–119). It held that since the approval of the plan by the Supreme Court of New York was conditioned upon the consent of the proportion of the certificate holders prescribed by statute, the transfer in pursuance of the order

[3] No tax was assessed upon the earlier transfers, to the Superintendent of Insurance and to the Mortgage Commission, it being conceded that they were "wholly by operation of law" within Regulations 71, Article 35 (r).

could not be regarded as "wholly by operation of law" (R. 115).

ARGUMENT

This case is similar to *Niagara Hudson Power Corporation* v. *Hoey,* 117 F. (2d) 414 C. C. A. 2d, which was decided by the court below in part upon the authority of the present case, and which is now pending on petition for certiorari, No. 871 this Term. Most of the contentions of the present petitioners are answered in the Government's brief in opposition in that case, to which the Court is respectfully referred.

In addition to contentions made in the *Niagara Hudson* case, the present petitioners claim exemption under Article 35 (h) of Treasury Regulations 71 (1932 edition), which provides:

> (h) The transfer of stock from the name of a deceased or resigned trustee to the name of a substituted trustee appointed in accordance with the terms of the original trust agreement, which is a transfer resulting wholly by operation of law.

Petitioners urge that the various New York statutes pursuant to which the transfers occurred are to be considered as incorporated into the "trust agreement", and that the decision below conflicts on this point with *United States* v. *Merchants Nat. Trust & Savings Bank,* 101 F. (2d) 399 (C. C. A. 9th).

In the *Merchants* case, as petitioners state (Pet. pp. 14–15), "The court found that since the Cali-

fornia Banking Act was in existence at the time the trust agreement was executed, the provisions for the substitution of the Trustees, as contained in the statute, were incorporated in the trust agreement as a matter of law." Here, on the other hand, the New York statutes were not enacted until after the execution of the trust agreement. The regulation specifies "original" trust agreement, and even if subsequently enacted legislation be considered as incorporated in the trust agreement it does not constitute "terms of the original trust agreement." The word "original" was added in the 1932 revision of Regulations 71, and was not in the regulations before the Ninth Circuit in the *Merchants* case. Accordingly there is no possibility of a conflict.

CONCLUSION

For the reasons stated in the brief in opposition in the *Niagara Hudson* case and herein the petition should be denied.

Respectfully submitted.

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Special Assistants to the Attorney General.

APRIL 1941.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9, as amended by Section 724 of the Revenue Act of 1932, c. 209, 47 Stat. 169:

TITLE VIII—STAMP TAXES

SEC. 800. On and after the expiration of thirty days after the enactment of this Act there shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in Schedule A of this title, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, by any person who makes, signs, issues, sells, removes, consigns, or ships the same, or for whose use or benefit the same are made, signed, issued, sold, removed, consigned, or shipped, the several taxes specified in such schedule. The taxes imposed by this section shall, in the case of any article upon which a correspondent stamp tax is now imposed by law, be in lieu of such tax.

* * * * *

SCHEDULE A—STAMP TAXES

* * * * *

9. *Bonds, etc., sales or transfers:* On all sales, or agreements to sell, or memoranda of sales or deliveries of, or transfers of legal title to any of the instruments mentioned or described in subdivision 1 and of

a kind the issue of which is taxable thereunder, whether made by any assignment in blank or by any delivery, or by any paper or agreement or memorandum or other evidence of transfer or sale (whether entitling the holder in any manner to the benefit of such instrument or not), on each $100 face value or fraction thereof, 4 cents: * * *.

Treasury Regulations 71 (1932 Ed.):

ART. 34. *Sales or transfers subject to tax.*—The following are examples of transactions subject to the tax:

* * * * *

(b) The transfer of stock to or by trustees.

* * * * *

ART. 35. *Sales or transfers not subject to tax.*—The following are examples of transactions not subject to the tax:

* * * * *

(d) The surrender of the stock of the consolidating corporation in exchange for stock in the consolidated corporation, in the case of consolidation of two or more corporations.

(e) The transfer of the stock of a merged corporation in exchange for stock of the merging corporation at the time and as a part of a statutory merger, and the substitution of new certificates for the certificates representing the old stock of the merging corporation.

* * * * *

(h) The transfer of stock from the name of a deceased or resigned trustee to the name of a substituted trustee appointed in accordance with the terms of the original

trust agreement, which is a transfer resulting wholly by operation of law.

* * * * *

(r) Transfers of shares or certificates of stock which result wholly by operation of law are not subject to the tax. Transfers of this character are those which the law itself will effect without any voluntary act of the parties, such as transfer of stock from decedent to executor.

(s) Where trustees hold as joint tenants, upon the death of one title devolves upon the survivor. Such devolution constitutes a transfer by operation of law not subject to tax.

* * * * *

U. S. GOVERNMENT PRINTING OFFICE: 1941